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No. 932

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

LEONARD S. GOODMAN and BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY, Plaintiff-Appellee Below, and N. M. COHEN, EMANUEL COHEN, JACOB LEHRMAN, ISRAEL COHEN, GIANT FOOD, INC., CHARLOTTE FERSON LEHRMAN, JOSEPH B. DANZANSKY; and ISRAEL COHEN, EMANUEL COHEN, and LILLIAN C. SOLOMON, doing business as MAX SHAPIRO, Defendants-Appellees Below, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

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No.

LEONARD S. GOODMAN and BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY, ET AL., *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

Petitioners, Leonard S. Goodman and Barbara L. Goodman, pray that a writ of certiorari issue to review the final decree of the Supreme Court of the State of Delaware entered on October 25, 1965.

OPINION BELOW

The Chancery Court of the State of Delaware entered its unreported letter-opinion in this case (App. (Appendix hereto) 3a) on January 28, 1965, and its final order on February 3, 1965. The Supreme Court of the State of Delaware entered its opinion (App. 4a-

11a) on September 17, 1965, and its final decree (App. 12a) upon denying the petition for reargument; this opinion is reported at 213 A. 2d 899.

JURISDICTION

The court below entered its final decree or mandate on October 25, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1257, 2101(c). *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38, 40; and see *Standard Oil Co.* v. *Johnson*, 316 U.S. 481, 483.

QUESTION PRESENTED

The public stockholders of a supermarket chain (a Delaware corporation) complained that the officers and directors were requiring it to purchase all its produce requirements through a middleman composed of, and thereby profiting, such officers and directors. The arrangement with the middleman was described in the prospectus connected with the first public offering and with subsequent new offerings of the corporation's common stock. The question presented is whether the Delaware court lawfully barred relief, on grounds that all public investors had consented with actual knowledge of the arrangement, solely on the holding that the Securities Act of 1933 required the prospectus be delivered to each and every prospective purchaser of the new shares prior to his effecting a purchase.

STATUTE INVOLVED

The statute primarily involved is Section 5(b)(2) of the Securities Act of 1933, 48 Stat. 77, 15 U.S.C. 77e(b)(2), which provides:

> It shall be unlawful for any person directly or indirectly . . . to carry or cause to be carried

through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

Also material to this appeal is Section 16 of the Securities Act of 1933, 48 Stat. 84, 15 U.S.C. 77p, which saves to every litigant "any and all other rights and remedies that may exist at law or in equity."

STATEMENT

Petitioners are two stockholders, husband and wife, who purchased 425 shares of common stock of Giant Food, Inc., a Delaware corporation operating a chain of supermarkets in and around Washington, D. C., on the American Stock Exchange in May, 1964. Respondent Futrovsky, also a stockholder of Giant, brought the original suit out of which this appeal arises derivatively on behalf of Giant in the Delaware Chancery Court against respondents Cohen and other officers and directors of Giant. Futrovsky alleged that these officers and directors had wasted and were continuing to waste Giant's assets by requiring Giant to purchase all its produce requirements through a partnership (called "Max Shapiro" or herein "Shapiro") composed of these same officers and directors, rather than directly from suppliers, for the sole purpose of enriching these officers and directors at the expense of the corporation and its common stockholders.

Before the petitioners entered the case in the Chancery Court, Futrovsky, purporting to represent all the common stockholders, had developed a record showing that Giant issued its first public shares of common stock in 1959, but that all voting shares remained

in the hands of the officers and directors composed entirely of representatives of the two original families (Cohens and Lehrmans) which founded the chain. Futrovsky conceded on this record that he had received a prospectus in 1959, which described the arrangement between Giant and Shapiro and related that the officers and directors would continue to profit from the arrangement. But, he further developed facts beyond those set forth in the prospectus, namely that Shapiro has provided no bona fide business service to Giant since the end of World War II;[1] Shapiro owns no assets, except a small amount of working capital to buy produce for the few days before Giant pays for it (Tr. 29, 70-71); Shapiro uses Giant's trucks and accounting equipment and operates out of Giant's produce warehouse (Tr. 21, 22, 74); Shapiro's only customer is Giant (Tr. 28); Shapiro's salaried personnel, who ensure the quality of produce bought for Giant, are employees of Giant (Tr. 22, 35); and each year the Shapiro partnership receives from Giant from $350,000 to $400,000 over the cost of its operation which redounds to the benefit of Giant's officers and directors.

The plaintiff Futrovsky and the defending officers and directors, nevertheless, proposed a settlement before the Chancery Court which provided that, (1) the Giant-Shapiro arrangement should continue for another 10 years; (2) Shapiro's profit each year in this

---

[1] The officers and directors defended the Shapiro arrangement only on the allegation it encouraged the Giant store managers to return defective produce, which returns had for years admittedly been *de minimis*, amounting only to one or two percent. (Tr. 26, 34-36). ("Tr." herein refers to the transcript of the depositions taken in 1964 in the Chancery Court.)

period should be $350,000; (3) at the end of the 10-year period, Giant would have the option of buying out the partnership for $1,500,000; and (4) Futrovsky's counsel should receive a fee of $100,000. (App. 5a-6a). All stockholders were notified of this proposed settlement. Petitioners and another stockholder appeared before the Chancery Court to object. When that court approved the settlement, the petitioners appealed to the Delaware Supreme Court.

Respondents argued in the Chancery Court in support of their settlement that all the public shareholders in 1959 had consented to the Giant-Shapiro arrangement, and that petitioners were now barred from attacking the arrangement by the prior consent. Recognizing that Delaware law requires actual knowledge by stockholders of any matter consented to,[2] respondents sought to establish such knowledge solely upon the assertion that the Securities Act required that each investor receive a prospectus containing full disclosure of the arrangement prior to his effecting any purchase. Futrovsky's counsel, for example, asserted in the Chancery Court that "nobody was permitted to buy a share of stock on this original issue without his first being delivered in hand . . . the prospectus" (App. 1a); and counsel for the individual defendant-respondents agreed, that each public investor was "buying his shares with this prospectus before him." (App. 2a).

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[2] *Cahall* v. *Lofland*, 12 Del. Ch. 299, 114 Atl. 224 (1921), *aff'd*, 13 Del. Ch. 384, 118 Atl. 1 (D. Sup. Ct. 1922); *Triplex Shoe Co.* v. *Rice & Hutchins*, 16 Del. Ch. 298, 147 Atl. 317 (1929), *aff'd*, 17 Del. Ch. 356, 152 Atl. 342 (D. Sup. Ct. 1930); *Gottlieb* v. *McKee*, 34 Del. Ch. 537, 107 A. 2d 240 (D. Ch. 1954); *Elster* v. *American Air Lines*, 34 Del. Ch. 94, 100 A. 2d 219, 221 (D. Ch. 1953).

The Chancery Court approved the settlement upon the ruling of law, as urged by respondents, that if the suit should go to trial, petitioners and all other public stockholders could not withstand the defenses of ratification or acquiescence (App. 3a). The court took no evidence on respondents' assertions regarding the Securities Act, for none was proffered.

Petitioners appealed to the Delaware Supreme Court, arguing that federal law did not require the delivery of a prospectus to all the prospective purchasers of new shares, and certainly not before they had effected their purchases; and that the Chancery Court had erred as a matter of law in failing to require proof that all shareholders had in fact bought their shares with knowledge of the Giant-Shapiro arrangement in 1959, and in 1961 and 1963 as further new shares were distributed, in the absence of a statutory requirement that a prospectus be delivered in time to afford such knowledge. Respondents' counsel reiterated their assertion, that in 1959 the investing "public purchased Giant's shares on the basis of the Prospectus" (App. 2a).

The Delaware Supreme Court affirmed the settlement and held further relief was "precluded." It first stated that the Cohen and Lehrman families had decided not to include their Shapiro holdings in the 1959 offering of Giant stock, and next stated that, "The buying public may not complain of that decision as long as it was not misled to its injury." (App. 9a).

The court concluded that all public shareholders had not been misled to their injury, but rather "knew" of the arrangement "at the time they were buying into Giant" (App. 9a), on the sole ground that, "Section

5(b)(2) of the Securities Act of 1933 (15 U.S.C. §§ 77, et seq.) required as a practical matter that the 1959 purchasers of Giant stock be furnished with a copy of the Prospectus" (App. 10a). The court states that "full disclosure . . . was made in the Prospectus under which the stock was offered to the public," and "in the light of this knowledge," which the purchasers allegedly had at the time they were buying into Giant, they may not now complain (App. 9a).

In further response to petitioners' argument that there was "no proof that the public stockholders of Giant in fact received copies of the Prospectus prior to the purchase of their stock" (App. 9a), the court added: "On the record before us we think we would be wrong to ascribe to the underwriters an intention to circumvent the clear intention of the Securities Act which is to force full disclosure of pertinent information. . . . We think it most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge of the separate existence of Shapiro and the intention to continue that separate existence." (App. 10a).

REASONS FOR GRANTING THE WRIT

The court below denied petitioners' relief upon the bare holding of law that the federal securities act requires the delivery of a prospectus to all purchasers of newly-issued shares prior to their effecting a purchase. As a decision of law, the court clearly erred, for the statute on its face requires no such result. Even as a piece of judicial legislation, the decision implements no federal policy, but in fact hinders the essential policy of the Act and only succeeds in destroying a State right of action which Section 16 of the Securities

Act seeks to preserve. As the court below decides much of the nation's corporate law, the public will broadly suffer under this ruling.

The ruling below applies the Securities Act against the investing public in a way never intended by Congress. The Securities Act was enacted to protect innocent investors, *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38, 40, 43, but the court below uses the Act to bar the investors from rectifying an arrangement between the corporation and a middleman that profits only the officers and directors of the corporation. The prospectus is made available to management under the decision below as a shield against the complaint of the public investors.

Moreover, a prospectus serves its purpose to inform the investing public in proportion to its distribution prior to consummated stock sales. See *Frost* case, *supra*, 312 U.S. at 40. By conclusively presuming there has been distribution to all prospective buyers as a matter of law, the lower court encourages the smallest permissible distribution of the prospectus. For those with something to hide from the public in the prospectus, the decision below provides the consolation they will not have to prove that distribution of the prospectus occurred. The result would not be so inimical to the interests of the investing public but for the fact there is a wide leeway allowed by the Securities Act to avoid a wide distribution, let alone 100% distribution, of the prospectus prior to consummated stock purchases by the public.

By its own terms, Section 5(b)(2) as a minimum requires only that a prospectus "accompany" the new shares, that is, be sent to the purchaser with delivery

of his shares after the sale has taken place. Except where there is fraud, when a right of recission may apply, the completed sale very often will occur prior to delivery of the prospectus. This is uniformly recognized by the authorities in the field. *E.g.,* 1 Loss, *Securities Regulation,* 182, 246 (2d ed. 1961).

Securities may be sold orally, either in personal conversation or by telephone prior to the delivery of any prospectus, which will normally occur pursuant to Section 5(b)(2) only after the purchase has been consummated. For example, the article by Byse and Bradley, "Proposals to Amend the Registration and Prospectus Requirements of the Securities Act of 1933," 96 *Pa.L.Rev.* 609, 619, states:

> [I]f the offer or attempt to dispose of the security is made orally, either in personal conversation or by telephone, the only requirement imposed by the Act is that if the mails or channels of commerce are used to deliver the security to the purchaser, a Section 10 prospectus must accompany or precede the security. Consequently, where the seller does not utilize written communications in selling the security, *the buyer need receive no prospectus until the security is delivered to him after he has purchased the security.* [Emphasis added].

And as Professor Loss states in reference to selling securities orally, either in person or by telephone:

> Thus it is possible in many cases to offer and sell without even a technical violation, either before or after effective registration, and deliver a statutory prospectus for the first time with the confirmation or the security—if, indeed, the mails or interstate facilities are used at that stage.

To be sure the court below deftly couched its holding in language which sounds like findings of fact. It stated that the Securities Act requires delivery of a prospectus within the appointed time "as a practical matter"; and "we think it most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge . . . ". (App. 10a). No evidence or authority support these purported findings. The assertions of the court below are contrary to all the authorities which were before it. Petitioners cited the Byse and Bradley article, *supra,* for example, which states (at 617):

> To the extent that new issues are sold through oral negotiations, the Act's professed objective of providing public investors with sufficient information to reach informed judgments is not effectuated. Although detailed data concerning the percentage of newly issued securities sold orally is not available, the following statement of the securities industry is revealing: *"With respect to the greatest percentage of new issue securities measured by dollar amount . . . business between buyer and seller is normally conducted by telephone." This opinion by qualified observers indicates that despite the existence of the Securities Act, a large number—perhaps, in the language of the industry statement, "the greatest percentage" —of public investors purchase newly issued securities without full benefit of the disclosure provisions of the Act.* [Emphasis added].

See also Loss, *supra,* at 207-208. Moreover, this customary practice does not arise out of any intent on the part of underwriters to circumvent the Securities Act, but from an honestly-held industry belief that such conduct and practice were not intended to be regu-

lated by Congress. This is demonstrated in Loss, *supra,* at 209; and Byse and Bradley state (at 617-18):

> The securities industry, pointing to the deletion of provisions in earlier drafts of the Act which would have regulated oral offerings, argues that Congress deliberately chose not to impose such "an unnecessary and perhaps impossible restriction . . . upon business." We do not think it necessary to attempt a resolution of this controversy. The point is that under the Act a multitude of public investors still are not provided with information concerning the securities they are asked to purchase.

Where Congress has intended to reach oral communications under the Securities Act, it has done so expressly. Section 12, 48 Stat. 84, 15 U.S.C. 77*l*, for example, creates a civil cause of action against one who sells fraudulently "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication." The phrase "oral communication" here "certainly would include telephone conversations as means of communication in interstate commerce and perhaps broadcasts by radio, and these two means of 'oral communication' alone might well include a large segment of the communications in interstate commerce which Congress intended to reach." *Kemper* v. *Lohnes,* 173 F. 2d 44, 46 (7th Cir. 1949).[3]

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[3] Many cases have arisen under the Securities Act involving face-to-face sales where the Act was held not to apply. *E.g. Boone* v. *Baugh,* 308 F. 2d 711 (8th Cir. 1962). Where the mails have been used only to deliver the security, the circuits are split over whether Section 12 applies. Compare *Kemper* with *MacClain* v. *Bules,* 275 F. 2d 431, 433-34 (8th Cir. 1960), and *Blackwell* v. *Bentsen,* 203 F. 2d 690, 693 (5th Cir. 1953).

No comparable language and hence no comparable intention appear in Section 5(b)(2).

As early as 1941, the Securities and Exchange Commission reported to Congress that Section 5(b)(2) does not require the delivery of a prospectus prior to effective sales of securities, as follows:

> Where the seller avoids making a written offer, a prospectus is not required to be given to the buyer until the security is delivered. *Representatives of the securities industry have stated to the Commission that it is their practice in many cases to take full advantage of the present statutory language* by entering into oral contracts with investors for the sale of securities and sending the required prospectus later, usually at the time of confirmation of the sale. *Thus the investor frequently does not see the prospectus until after he has actually become a purchaser.*[4] [Emphasis added].

Thus, contrary to the decision below it is most probable that the original purchasers of Giant stock did not receive any prospectus until the delivery of their shares occurred after they had purchased them. As Professor Loss states (*supra* at 208):

> A prospectus which comes with the security does not tell the investor whether or not he should buy; it tells him whether he has acquired a security or a lawsuit.

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[4] Report of the Securities and Exchange Commission on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, August 7, 1941, Print of the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., page 5. The Commission then did not advocate a change, apparently preferring to hold the line against other changes proposed by the securities industry which would have weakened the statute even more (*id., passim*).

And, too, the absence of any evidence of record or authority below, which might be cited to support their holding,[5] shows that in substance and effect it is no more than a holding of law; and, of course, this Court will not be beguiled by the form of the court's holding below. On the contrary, this Court should "examine the entire record, including the evidence . . . to determine whether what purports to be a finding upon questions of fact is so involved with and dependent upon such questions of law as to be in substance and effect a decision of the latter." *Kansas City So. Ry.* v. *Albers Comm. Co.*, 223 U.S. 573, 591. See also *Sterling* v. *Constantin*, 287 U.S. 378, 398; *Great Northern Ry.* v. *Washington*, 300 U.S. 154, 167; *United Gas Co.* v. *Texas*, 303 U.S. 123, 143; *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652, 659.

The decision below infringes the ruling of this Court in *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38. There the State Court sustained a defense to an investor's contract action solely on the grounds that the Securities Act barred the suit by rendering the underlying contract void. This Court reversed the State court's adding to "the sanctions which Congress has defi-

[5] The court below was much impressed with the fact that the plaintiff Futrovsky had conceded that he for one had received a prospectus in 1959. (App. 10a). Futrovsky's admission, however, merely proved he was in no position to, and indeed had no interest in, pursuing the question before the Chancery Court as to whether all stockholders had received a prospectus. The failure of the court below to understand the implications of Futrovsky's admission also led it to depart from *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549-50, for it accepted a settlement negotiated by one who could not faithfully assume a "position having a fiduciary character" as the "self-chosen representative and a volunteer champion" of all the Giant stockholders.

nitely provided" (at 42), where it would not further the Act's essential purpose of protecting innocent investors, but actually hinder that purpose. Similarly here, the lower court has "misinterpreted and improperly applied the Securities Act" (at 45) to the detriment of investors by giving the Act a broader reach than intended by Congress.

CONCLUSION

The question presented by the decision below is a narrow, but important, question of interpretation of the Securities Act, not involving the exact contours of the duty to deliver a prospectus, but only broadly whether there is the legal duty to deliver to all prospective buyers prior to their purchasing newly-issued shares. The novel interpretation of the federal statute below— in order to perpetuate the profiteering of corporate officers and directors described in the prospectus—is supported by no authority or facts of record. It is urged that a writ of certiorari to review the decision and decree of the court below be granted, and that this Supreme Court rule that the court below may not so misread and misuse the Securities Act.

Respectfully submitted,

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Washington, D. C. 20012.

January, 1966.

APPENDIX

Pertinent Extracts From Respondents' Argument in the Lower Courts

In the Chancery Court:

By Counsel for Futrovsky, the plaintiff-appellee below (Transcript of January 27, 1965, at pp. 6-7):

> Unless there be any doubt or misgivings about the future, the public was informed before they put their dollars on the barrelhead and bought their shares that it was the intention of the partners of Max Shapiro, the Lehrmans and the Cohens, that the net profits of the partnership in future years—that is after the public came in with their investments—would continue in the percentage range as high as 4.9% established in the past seven years.
>
> As your Honor knows, under the applicable law, nobody was permitted to buy a share of stock on this original issue without his first being delivered in hand—not by constructive notice, not by fictional notice, but by actual delivery in hand of the piece of paper which I am now holding in my hand, which is the prospectus, and this notification of what had been before and what was to continue in the future.
>
> . . . Not 99%, your Honor, but 100% of the shareholders who bought their subscriptions knew about this—actually, and not constructively merely.

By Counsel for the individual defendant-appellees below (*id.* at pp. 21-22):

> Your Honor, I will point out—I don't know whether Mr. Pomerantz [Counsel for Futrovsky] did—that the Securities Act requires that on a public offering of stock by an issuer such as this offering we have here, for a period of 60 days, I think, the law requires that

the purchaser receive a copy of the prospectus, and as Mr. Pomerantz pointed out, at page 12 of the prospectus which was issued in September, 1959, there is a complete disclosure of the relations between Giant and Max Shapiro. I agree with Mr. Pomerantz that there is in effect—each stockholder buying his shares with this prospectus before him—I agree with Mr. Pomerantz that there has been 100% acquiescence and ratification by the stockholders of these arrangements.

In the Delaware Supreme Court:

By Counsel for Futrovsky (Brief, pp. 10-11):

> The public purchased Giant's shares on the basis of the Prospectus. The purchasers were thus put on notice, by the Prospectus, that Giant's dealings with Max Shapiro would henceforth continue in the future as in the past. This was one of the essential foundations of the contract created by the Prospectus offering and its acceptance by the purchasers of Giant's stock.

By Counsel for the individual defendants (Brief, p. 24):

> In short, the [Securities] Act requires, as a practical matter, that all purchasers of Giant shares in 1959 be furnished with a copy of the prospectus . . .

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

Isaac D. Short, 2nd
Vice-Chancellor

Court House
Georgetown, Delaware

January 28, 1965

Irving Morris, Esquire
Bank of Delaware Building

Howard M. Handelman, Esquire
Bank of Delaware Building

Richard F. Corroon, Esquire
350 Delaware Trust Building

Richard L. Sutton, Esquire
3000 duPont Building

Edward Rappaport, Esquire
38 N. Main Street
Gloversville, N. Y.

Re: Futrovsky vs. Cohen
C.A. No. 1930

Gentlemen:

I have considered the terms of the proposed settlement in the above matter in the light of the objections thereto made by the stockholders Goodman and Cash and am satisfied that the terms proposed are fair and equitable. I am satisfied, also, that if this litigation were pursued it is most unlikely that the stockholders would obtain even the benefits that the settlement provides. I say this for the reason that the cause of action stated in the complaint and reasserted by the objectants could not, in all probability, withstand the defense of estoppel, whether by ratification or acquiescence.

I am not impressed by the tax arguments advanced by Mr. Rappaport. Not only is no tax assessment threatened, but it is doubtful that an assessment could properly be made under the circumstances.

Accordingly, the motion of the Goodmans for leave to intervene is denied, the objections are overruled, and an order will be signed, on presentation, approving the proposed settlement.

Yours very truly,

/s/ Isaac D. Short, 2nd.

IDS:r
cc: Register in Chancery

IN THE SUPREME COURT OF THE STATE OF DELAWARE

No. 31, 1965

Leonard S. and Barbara L. Goodman, Objecting Stockholders of Giant Food Inc., Below, *Appellants*,

v.

Charles J. Futrovsky, Plaintiff Below, *Appellee*,

and

N. M. Cohen, Emanuel Cohen, Jacob Lehrman, Israel Cohen and Giant Food Inc., Appearing Defendants Below; Charlotte Ferson Lehrman, Joseph B. Danzansky, and Israel Cohen, Emanuel Cohen and Lillian C. Solomon, doing business under the firm name and style of Max Shapiro, non-appearing Defendants Below, *Appellees*.

(September 17, 1965)

Wolcott, Chief Justice; Carey, Justice, and Wright, Judge, sitting.

Appeal from the Court of Chancery in and for New Castle County.

Richard L. Sutton of Morris, Nichols, Arsht & Tunnell, Wilmington, and Leonard S. Goodman, Washington, D. C., for appellants.

Irving Morris of Cohen, Morris & Rosenthal, Wilmington, and Abraham L. Pomerantz of Pomerantz, Levy, Haudek & Block, New York City, for appellee Charles J. Futrovsky.

Howard M. Handelman of Bayard, Brill, Russell & Handelman, Wilmington, for Giant Food Inc.; Richard F. Corroon of Berl, Potter & Anderson, Wilmington, for individual defendants, and Danzansky & Dickey, Washington, D. C.

WOLCOTT, C. J.:

This is an appeal by objecting stockholders of Giant Food, Inc., (hereafter "Giant") from the Vice Chancellor's approval of a settlement of a stockholder's derivative action. The action was commenced by the stockholder, Goodman [sic], appellee here. The complaint charged that the officers and directors of Giant caused it to purchase all of its produce requirements from Max Shapiro, a partnership, owned by the Cohen and Lehrman families, also in control of Giant; that Shapiro serves no useful business purpose for Giant; and that Shapiro is solely a device to divert profits from Giant to the Cohen and Lehrman families. As an alternative, the complaint charged that if in fact Shapiro did perform a business function for Giant, its profits had become excessive.

Following a period of legal research and discovery, plaintiff's counsel concluded that the first theory advanced in the complaint was without merit, but that the second theory, i.e., the unfairness to Giant of the excessive earnings of Shapiro, under the rule of *Rogers* v. *Hill,* 289 U.S. 582, 53 S. Ct. 731, and *Saxe* v. *Brady,* 40 Del. Ch. 474, 184 A. 2d 602, held forth some prospect of recovery. In the light of this conclusion the settlement agreement was negotiated.

The settlement provided in substance that Giant and

Shapiro shall enter into a 10-year contract under which Shapiro shall supply all produce required by Giant; that Shapiro's annual profits shall be the lesser of 3.9% of its net sales to Giant, or $350,000; that at the end of the contract period Giant shall have an option to purchase Shapiro for $1,500,000; that releases shall be given to the individual defendants, and that Giant shall pay plaintiff's counsel a fee of $100,000.

The Vice Chancellor ordered notices to be sent to the 2,770 stockholders of Giant of a hearing on the fairness of the proposed settlement. At the hearing the objectors, appellants here, and one other stockholder appeared in opposition to the settlement. The Vice Chancellor approved the settlement and this appeal followed.

A short statement of the factual background of Giant and Shapiro seems required. In 1935 the Cohen and Lehrman families started a supermarket business in the Washington, D. C. area. The enterprise has since been and is now under the equal control of the Cohen and Lehrman families. Giant grew from one store opened in 1936 to fifty supermarkets in 1959, grossing an average of $2,650,000 annually per store.

Prior to 1940 Giant purchased its produce direct from wholesalers but in 1940, in order to establish and maintain a uniform standard for produce, formed a produce company to supply its produce requirements. Accordingly, Washington Wholesale Produce Company was organized and financed by the Cohen and Lehrman families. This company acquired produce from other wholesalers in less than carload lots and then resold it to Giant.

During World War II, due to the heavy demands of the armed services, the primary sources of produce established a quota system among wholesalers. No such quota was available to Washington Wholesale Produce Company since it had always theretofore purchased produce through other wholesalers. Giant, therefore, found itself at a dis-

advantage in acquiring the produce needed for retail in its stores.

In 1944 Max Shapiro, a large produce wholesaler in the Washington area, was offered for sale. Primarily, in order to acquire the quotas belonging to Shapiro, the Cohen and Lehrman families bought it, using funds supplied from their personal assets. At the time of this purchase the members of these two families were the only stockholders of Giant.

Shapiro thereafter has supplied the produce requirements of Giant. In so doing, it sells to Giant at prices which enable Giant to retail on a competitive basis, which sometimes requires Shapiro to readjust its prices to Giant, even on occasion taking a loss on some particular item. The result has been a constantly maintained high standard for produce. So much so that the rate of rejection of low quality produce by Giant has been reduced in the past few years to only 1% or 2%.

In 1959, in order to further expand Giant, the Cohen and Lehrman families decided to attract new capital by a public offer of Giant stock. Accordingly, in that year, through Auchincloss, Parker & Redpath, and Kidder, Peabody & Co. Incorporated, principal underwriters, 200,000 shares of nonvoting Common Stock A was sold to the public at $16 per share. The offer was made with the stated intention on the part of Giant to put the Common Stock A on an annual dividend basis of 40¢, which has since been maintained.

Prior to the public offer of Giant Common Stock A the underwriters suggested to the Cohens and Lehrmans that they include Shapiro in Giant's assets in consideration of 135,000 shares of Common Stock A, later increased to 335,000 shares. Finally, however, the underwriters and the directors of Giant concluded that an additional 335,000 shares would dilute the offer of Common Stock A to be

offered to the public. It was therefore concluded wise to continue the separate existence of Giant and Shapiro.

The Common Stock A was sold in 1959 under a Prospectus which fully revealed the relationship between Giant and Shapiro, including ownership of Shapiro by the Cohen and Lehrman families. In this connection, it was stated that Shapiro did business only with Giant, that its earnings varied from 3.5% to 4.4% of its net sales to Giant, amounting in 1959 to $334,715, and that it was the intention of the owners of Shapiro to continue its net profit from its business with Giant for the future in the established percentage ranges.

The Prospectus of 1959 was followed with others of 1961 and 1963, all of which are on file with the Securities and Exchange Commission and the American Stock Exchange. All of them set forth to the same extent as in the original the Giant-Shapiro relationship.

We are concerned in this appeal with review of the approval of a settlement of a derivative action. The function of this Court in such a review is merely to determine whether or not the court below has committed an act of judicial indiscretion in approving the settlement in the exercise of business judgment. We do not exercise our own judgment to determine anew the question of the intrinsic fairness of the settlement. *Hoffman* v. *Dann,* 205 A. 2d 343.

The appellants take the position that the purchase by Giant of all of its produce requirements from Shapiro is a fraud upon Giant and its Common Stock A since, it is argued, it serves no purpose other than diverting to the Cohens and Lehrmans profits which otherwise would inure to the benefit of Giant's stockholders. They say, therefore, that it was improvident to enter into the settlement before us dismissing a cause of action clearly meritorious.

We think, however, that appellants are wrong when they categorize the original acquisition of Shapiro by the

Cohens and Lehrmans as a fraud on Giant. At the time of acquisition the Cohens and Lehrmans were the sole owners of Giant and could do with it as they wished. It was entirely proper, at least at that time, for them to decide to acquire Shapiro and keep its existence separate from Giant. Particularly is this so when they used their own money, not Giants, to make the purchase. At the time of purchase, furthermore, there was no one with standing to object to the decision thus made.

The situation, therefore, was that the Cohens and Lehrmans at the time the public offer of Giant stock was made owned two separate and distinct businesses. They finally determine to permit the public to buy a share of only one of them—Giant. This, it seems to us, was their privilege, and the buying public may not complain of that decision as long as it was not misled to its injury.

The plain fact is that in 1959 there was no intention on the part of the Cohens and Lehrmans to include Shapiro as an asset of Giant in their offer to sell Giant stock. Full disclosure of that fact was made in the Prospectus under which the stock was offered to the public. It is quite plain, therefore, that the purchasers of Giant stock knew at the time that they were buying into Giant and that Giant for the future would continue to buy its produce from the independent wholesaler, Shapiro. In the light of this knowledge the purchasers will not be heard to now claim that they are entitled to something for which they have not paid.

If authority is needed for this conclusion, it is to be found in *Solimine* v. *Hollander,* 128 N.J. Eq. 228, 16 A. 2d 203, a case almost directly in point. We think, however, no authority is needed to support a conclusion resting on common sense and elementary fairness.

Appellants argue that there is no proof that the public stockholders of Giant in fact received copies of the Prospectus prior to the purchase of their stock. However,

Section 5(b)(2) of the Securities Act of 1933 (15 U.S.C. §§ 77, et seq.) required as a practical matter that the 1959 purchasers of Giant stock be furnished with a copy of the Prospectus.

It is argued, however, that there are loopholes in Section 5 which were taken advantage of by the underwriters to insure that the original purchasers did not receive a copy of the Prospectus. The argument is tenuous at best and is directly contradicted by the answer averring that the plaintiff received a Prospectus at the time of his purchase. On the record before us we think we would be wrong to ascribe to the underwriters an intention to circumvent the clear intention of the Securities Act which is to force full disclosure of pertinent information.

We think it most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge of the separate existence of Shapiro and the intention to continue that separate existence. The original purchasers could not, therefore, successfully complain of the continuance of Shapiro as a separate business. *Finch* v. *Warrior Cement Corp.*, 16 Del. Ch. 44, 141 A. 54; *Elster* v. *American Airlines, Inc.*, 34 Del. Ch. 94, 100 A. 2d 219.

All of the present holders of Giant's Common Stock A including the objectors trace the title to their shares to the purchases of the 1959 issue. This being so, they are bound by the acquiescence, with full knowledge, of their predecessors and are now precluded from attacking the Giant-Shapiro relationship. 13 *Fletcher, Cyclopedia of Corporations*, § 5866; *Henderson* v. *Plymouth Oil Co.*, 15 Del. Ch. 40, 131 A. 165.

We think, therefore, that the first theory for recovery advanced in the complaint was properly determined by counsel for the plaintiff to have no merit. As a result of this, the settlement was negotiated upon the alternate theory of recovery, the allegedly excessive earnings of

Shapiro. Appellants, however, contend that the settlement in fact confers no benefit upon Giant.

We think to the contrary, however. In the first place the future earnings of Shapiro are limited to not in excess of $350,000 annually. The 1963 earnings of Shapiro were $403,767, and its estimated earnings on the old basis for 1964 and 1965 are $417,300 and $471,900 respectively. Assuming conservatively, in view of the rapid growth of Giant in the past and the prospect of a future continuance of growth for the future, that the savings to Giant made by the restrictions on Shapiro's profit amounts to $100,000 annually, the total saving to Giant over the ten-year life of the contract is $1,000,000.

In addition, at the end of the contract term Giant has an option to purchase Shapiro at the fixed price of $1,500,000 which is 4.8 times the $350,000 annual earnings of Shapiro permitted by the settlement. Furthermore, not without significance in this connection is the fact that in 1959 the underwriters offered in effect to purchase from the Cohens and Lehrmans the Shapiro business for 335,000 shares of the Common Stock A valued at $16 per share. This set a value of Shapiro at $5,260,000. We think, under the circumstances, that an option to purchase Shapiro for $1,500,000 cannot be said to be inequitable.

For the foregoing reasons we affirm the judgment below approving the settlement.

Mandate

THE SUPREME COURT OF THE STATE OF DELAWARE

To the Honorable the Judges of The Court of Chancery of the State of Delaware in and for New Castle County:

GREETING:

WHEREAS, before you or some of you in a cause entitled as follows:

Civil Action No. 1930

CHARLES J. FUTROVSKY

v.

N. M. COHEN, ET AL.

a certain judgment or order was entered on the 3rd day of February 1965, to which reference is hereby made; and

WHEREAS, by appropriate proceedings the said cause was duly appealed to this Court, and after hearing has been finally determined, as appears from the opinion of this Court filed in the cause on September 20, 1965, a certified copy of which is attached hereto;

ON CONSIDERATION WHEREOF IT IS ORDERED AND ADJUDGED that the said judgment or order be and it is hereby affirmed with costs, hereby taxed in the sum of One Hundred Fifty-seven and 80/100 Dollars ($157.80) to be recovered by the individual defendants against Leonard S. Goodman and Barbara L. Goodman with right of execution; and the said cause is hereby remanded with instructions to take such further proceedings therein as may be necessary in conformity with the opinion of this Court.

WITNESS the Honorable Daniel F. Wolcott, our Chief Justice, at Dover, the first day of January, A. D. 1965.

Issued October 25, 1965.

(SEAL) /s/ T. E. TOWNSEND, JR.
Clerk of the Supreme Court.

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IN THE

Supreme Court of the United States

October Term, 1965.

No. 932.

LEONARD S. GOODMAN and BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY,
Plaintiff-Appellee Below,

and

N. M. COHEN, EMANUEL COHEN, JACOB LEHRMAN, ISRAEL COHEN, GIANT FOOD, INC., CHARLOTTE FERSON LEHRMAN, JOSEPH B. DANZANSKY; and ISRAEL COHEN, EMANUEL COHEN, and LILLIAN C. SOLOMON, doing business as Max Shapiro,
Defendants-Appellees Below,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1965.

No. 932.

LEONARD S. GOODMAN AND BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY,
Plaintiff-Appellee Below,

and

N. M. COHEN, EMANUEL COHEN, JACOB LEHRMAN, ISRAEL COHEN, GIANT FOOD, INC., CHARLOTTE FERSON LEHRMAN, JOSEPH B. DANZANSKY; AND ISRAEL COHEN, EMANUEL COHEN, AND LILLIAN C. SOLOMON, DOING BUSINESS AS MAX SHAPIRO,
Defendants-Appellees Below,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

QUESTIONS PRESENTED.

1. Since the decision of the highest court of Delaware can be wholly sustained on independent grounds of state law, does this Court have jurisdiction under 28 U. S. C. § 1257(3)?

2. Is there a substantial federal question which this Court should review under 28 U. S. C. § 1257(3)?

STATEMENT OF THE CASE.

The judgment below approves the settlement of a stockholder's derivative action brought by a stockholder of Giant Food Inc., a Delaware corporation ("Giant"). The action was commenced February 13, 1964. Not until three months thereafter—in May, 1964—did the petitioners purchase their shares of Giant (Pet. 3).* On January 27, 1965, when the settlement which had been agreed to by the parties came before the Delaware Court of Chancery for approval, petitioners appeared as objectors thereto and were given full opportunity to be heard.

Having duly considered the evidence and the arguments in support of the settlement and the objections thereto, the Court of Chancery found that it was "fair, adequate and reasonable and in the best interests of Giant Food Inc. and all its stockholders" and entered judgment in favor of the individual defendants (51a).

Giant operates supermarkets in the Washington, D. C. area. Plaintiff below, who had bought his shares in 1959 when Giant first went public, complained that the officers and directors of Giant caused it to purchase all its produce requirements from a partnership known as Max Shapiro, which was owned by the directors and officers of Giant. The complaint alleged that the Max Shapiro-Giant relationship was a fraud on Giant and that Max Shapiro served no useful purpose and had been used solely for the purpose of diverting profits from Giant to its officers and directors. Alternatively, plaintiff charged that if Max Shapiro did perform a business function, the profits realized by it were excessive and unreasonable.

Prior to 1959, all the shares of Giant had been owned by members of the Cohen and Lehrman families. In 1940, the

* "Pet. —" refers to the petition herein. The pages of petitioners' appendix and respondents' appendix are numbered consecutively; references to pages 1a through 12a are to petitioners' appendix and to pages 17a through 52a are to respondents' appendix.

two families established the Washington Wholesale Produce Company, from which Giant purchased its produce. During World War II, the primary sources of produce established quota systems. Since Washington Wholesale Produce Company had bought its produce through other wholesalers, no quotas were available to it and it operated at a great disadvantage. In 1944, however, Max Shapiro, one of the largest wholesalers of produce in the Washington area, was put up for sale. In order to attain quotas and thus to enable Giant to sell produce to its customers, the Cohens and the Lehrmans, using their personal funds and not Giant's, bought Max Shapiro. *Goodman v. Futrovsky*, — Del. Ch. —, 213 A. 2d 899, 901 (1965). At the time of the purchase, the Cohens and Lehrmans were the only stockholders of Giant (6a-7a).

The Max Shapiro-Giant relationship operates to the advantage of Giant. The Supreme Court of Delaware summarized the testimony as follows (7a):

> "Shapiro thereafter has supplied the produce requirements of Giant. In so doing, it sells to Giant at prices which enable Giant to retail on a competitive basis, which sometimes requires Shapiro to readjust its prices to Giant, even on occasion taking a loss on some particular item. The result has been a constantly maintained high standard for produce. So much so that the rate of rejection of low quality produce by Giant has been reduced in the past few years to only 1% or 2%."

In late 1959, Giant for the first time sold shares to the public. 200,000 shares of non-voting Common Stock A were sold at $16 per share. Prior to the public offering, the underwriters suggested that the Cohens and the Lehrmans put Max Shapiro into Giant for a consideration of 335,000 shares of Common Stock A; this represented approximately $1 per share of Giant earnings for each $1 per share of Max Shapiro earnings and a total proposed consideration of $5,360,000 at $16 per share.

The underwriters and directors of Giant decided, however, that the issuance of an additional 335,000 shares would dilute the publicly held shares and

> ". . . it was decided that it would be in the interest of both all of the people, plus the people who purchased the stock, to continue this unique produce relationship that had been established with much blood, sweat and tears in order to arrive at the kind of produce standards we have to have. As a consequence, the underwriters felt it would be best to continue the arrangement as it was . . ." (21a)

The prospectus under which the Common Stock A was sold in 1959 fully revealed the relationship between Giant and Max Shapiro (30a):

> "The Company purchases its fruits and vegetables from Max Shapiro, a partnership. The beneficial interests in the partnership are held by the individuals listed under 'Principal Holders of Securities—Beneficial Ownership' herein and members of their immediate families, except that N. M. Cohen and Joseph B. Danzansky have no beneficial interest in the partnership. In the partnership's fiscal year ended January 31, 1959, Max Shapiro's net sales to the Company amounted to $7,657,805, or approximately 8% of Giant's total purchases. This amount represented 100% of Max Shapiro's total sales and 100% of the Company's fresh produce purchases during the period. The prices quoted by Max Shapiro to Giant are dictated by competitive circumstances, and the partnership's net earnings for the fiscal year ended January 31, 1959, before income taxes, partners' salaries and withdrawals, were $334,715 or about 4.4% of Max Shapiro's net sales to Giant. In the past seven fiscal years the corresponding net earnings of Max Shapiro varied from a low of 3.5% to a high of 4.4% of net sales to Giant. Max Shapiro rents its produce warehouse from the Company under

a lease which requires rental payments of $72,000 per year and still has eight years to run. The data contained in this paragraph regarding Max Shapiro are derived from audited statements of the partnership prepared by Schultz, Sorin & Co., independent Certified Public Accountants. It is the intention of the partners of Max Shapiro that net profits of the partnership in future years continue in the percentage range established in the past seven years."

Defendants' answer alleges that plaintiff received a copy of this prospectus "at the time of his purchase" (40a). This defense cause plaintiff's counsel "great concern" (Affidavit of Abraham L. Pomerantz in Support of Application for Allowance) and it may reasonably be inferred that plaintiff had a copy of the prospectus when he purchased his shares. Defendants also contended that pursuant to the Securities Act of 1933 all other persons who bought shares of Giant on the public offering in 1959 received copies of the same prospectus, advising them of Giant's relationship with Max Shapiro and the intent to continue that relationship. In addition to the 1959 prospectus, prospectuses of Giant dated February 24, 1961, October 4, 1961, February 13, 1963 and October 29, 1963 all disclosed the Max Shapiro-Giant relationship. All the prospectuses are on file with the Securities and Exchange Commission and the last four are also on file with the American Stock Exchange. All of them have been open to the inspection of petitioners, all other stockholders of Giant and the public (42a).

The settlement agreed upon by the parties and found by the Vice Chancellor to be fair and reasonable and in the best interests of Giant and its stockholders provided that Max Shapiro and Giant should enter into a 10-year contract under which Max Shapiro would supply Giant's produce requirements. The contract provides that Max Shapiro's annual profits shall be limited to the lesser of 3.9% of its net sales to Giant or $350,000. At the conclusion of the con-

tract period, Giant will have an option to purchase the Max Shapiro business for $1,500,000 (48a).

It is of interest to note the savings to Giant which will result from the contract. For the fiscal year ended January 25, 1964, Max Shapiro's net earnings were $403,767. For the fiscal years ended January 31, 1965 and January 31, 1966, it was estimated in the notice to stockholders that Max Shapiro's net sales to Giant would be $10,700,000 and $12,100,000, respectively. 3.9% of such figures are $417,300 and $471,900, respectively. *Goodman v. Futrovsky, supra* at 3, 213 A. 2d 903. Thus, if the $350,000 profit limitation contained in the contract had been applicable, a savings of $242,967 would have accrued during the 3-year period. In its opinion, the Supreme Court of Delaware valued the total saving to Giant over the 10-year life of the contract at $1,000,000 (11a). And, since the underwriters had suggested that Max Shapiro be sold for $5,360,000 of Common Stock A in 1959, the Supreme Court of Delaware said "that an option to purchase Shapiro for $1,500,000 cannot be said to be inequitable" (11a).

In the courts below, one of defendants' principal arguments in support of the settlement was that the Max Shapiro-Giant relationship did not constitute a fraud on the public stockholders of Giant as charged by the petitioners. The Supreme Court of Delaware agreed with defendants' contention. It said (8a-9a):

> "We think, however, that appellants are wrong when they categorize the original acquisition of Shapiro by the Cohens and Lehrmans as a fraud on Giant . . . It was entirely proper . . . for them to decide to acquire Shapiro and keep its existence separate from Giant . . .
>
> "The situation, therefore, was that the Cohens and Lehrmans at the time the public offer of Giant stock was made owned two separate and distinct businesses. They finally determined to permit the public to buy a

share of only one of them—Giant. This, it seems to us, was their privilege and the buying public may not complain of that decision as long as it was not misled to its injury."

It is difficult to see how the buying public could have been "misled to its injury". Every investor who could read the English language was informed that he was not paying for, and not getting, the earnings of Max Shapiro. Nevertheless, petitioners now seek to take those earnings away from the Cohens and Lehrmans and to add them to the income of Giant. Petitioners are trying to acquire for Giant free of cost what the underwriters had been unable to obtain for a consideration worth $5,360,000.

ARGUMENT.

1. It is well settled that this Court will decline to review state court judgments which are based on adequate non-federal grounds. *Murdoch v. City of Memphis,* 87 U. S. (20 Wall.) 590, 634-636 (1875); *Herb v. Pitcairn,* 324 U. S. 117, 125-126 (1945).

The State of Delaware has consistently adhered to the principle that a court, when called upon to approve a settlement and compromise of pending litigation, is not required to try the issues involved or to decide them on their merits. The court is only called upon to consider the nature of the claims, the possible defenses to them and the material and factual obstacles facing the plaintiff in the event of a trial and exercise a business judgment in determining whether the proposed compromise is reasonable in the circumstances. *In re Ortiz' Estate,* 26 Del. Ch. 240, 27 A. 2d 368, 473 (1942); *Perrine v. Pennroad Corp.,* 29 Del. Ch. 531, 47 A. 2d 479, 488 (1946); *Krinsky v. Helfand,* 38 Del. Ch. 553, 156 A. 2d 90, 94 (1959); *Manacher v. Reynolds,* 39 Del. Ch. 401, 165 A. 2d 741, 748 (1960); *Rome v. Archer,* — Del. Ch. —, 197 A. 2d 49, 54 (1964); *Kleinman v. Saminsky,* — Del. Ch. —, 200 A. 2d 572, 575 (1964), *cert. den.* 379 U. S. 900 (1964); *Hoffman v. Dann,* — Del. Ch. —, 205 A. 2d 343, 352 (1964), *cert. den.* 380 U. S. 973 (1965). Thus, in *Dann v. Chrysler Corporation,* — Del. Ch. —, 215 A. 2d 709, 713 (1965), the Chancellor said.

> "Plaintiffs assert that the settlement did not constitute an adjudication of the merits of the causes of action asserted. This is true in the sense that the process of approving a settlement does not require the court to determine claims on their merits as in ordinary litigation."

In the proceedings below, the Supreme Court of Delaware defined its function as follows (8a):

"We are concerned in this appeal with review of the approval of a settlement of a derivative action. The function of this Court in such a review is merely to determine whether or not the court below has committed an act of judicial indiscretion in approving the settlement in the exercise of business judgment. We do not exercise our own judgment to determine anew the question of the intrinsic fairness of the settlement. *Hoffman v. Dann,* 205 A. 2d 343."

And in *General Foods Corp. v. Cryo-Maid, Inc.,* — Del. Ch. —, 198 A. 2d 681, 684 (1964), the Supreme Court of Delaware said that in reviewing an exercise of discretion by the lower court, it would "only examine the record to determine, if possible, whether or not there could be a reasonable difference of view upon the propriety of his act. If there can be such a different reasonable view, then we have no course but to affirm his act". Since some persons of ordinary sound business judgment would certainly think the settlement of this litigation was fair and reasonable, the decision below can be wholly sustained on independent grounds of state law and this Court should deny the petition.

It is clear, therefore, that the Court of Chancery decided nothing on the merits but merely determined, in the exercise of its best business judgment, that the proposed settlement was reasonable under all the circumstances. The Supreme Court of Delaware also did not adjudicate the merits of the controversy and did no more than determine that the Court of Chancery had committed no judicial indiscretion in approving the settlement. Even if the Supreme Court of Delaware be deemed to have decided anything on the merits, its view that the Max Shapiro-Giant relationship was no fraud on the public stockholders of Giant completely disposed of the case and should be binding on this Court (see *supra,* p. 6).

2. The petition raises no substantial question which this Court should review under 28 U. S. C. § 1257(3). In

considering the proposed settlement, the Vice Chancellor's function was "to consider and weigh the nature of the claim, the possible defenses, and to exercise business judgment in determining whether or not the proposed settlement is reasonable". *Krinsky v. Helfand, supra* at 8, 156 A. 2d 94. The Supreme Court of Delaware merely reviewed the record to determine whether the Vice Chancellor abused his discretion. Petitioners ask this Court to review the settlement of a stockholder's derivative suit where great benefits were received by Giant and where the only issue is whether the Vice Chancellor abused his discretion in approving the settlement.

The principal thrust of petitioners' argument is directed against the statement in the opinion below that it was "most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge of the separate existence of Shapiro and the intention to continue that separate existence" (10a). That language, however, must be read in the context of settlement and with the realization that the Supreme Court of Delaware was not called upon to decide any issue on the merits. Nevertheless, we submit that the observation of the court below is entirely consistent with the record and with this Court's comment in *Frost & Co. v. Mines Corp.*, 312 U. S. 38, 40 (1940), that "The essential purpose of the [Securities Act of 1933] is to protect investors by requiring publication of certain information concerning securities before offered for sale".

Petitioners consistently overlook the fact that this case involves the judicial approval of a stockholder's derivative suit over which type of litigation "the state has plenary power". *Cohen v. Beneficial Loan Corp.*, 337 U. S. 541, 550 (1948). They argue their case as if it involved a judgment after a trial on the merits and not from a discretionary order approving a settlement. The purpose of a settlement is not to resolve issues, but to avoid the determination of difficult issues, whether factual or legal. On the basis of

the record we submit that the Vice Chancellor did not abuse his discretion when he exercised his business judgment in favor of the settlement and that the Supreme Court of Delaware correctly so held.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the petition should be denied.

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Appendix.

EXCERPTS FROM DEPOSITIONS.

(2) *

JACOB LEHRMAN, one of the defendants, called as a witness by the plaintiff, being first duly sworn by the Notary Public, testified as follows:

EXAMINATION.

By Mr. Silverman:

* * *

(6)

Q. At some point of time Giant Foods ceased to purchase its produce from a wholesaler and used the services of Max Shapiro. Is that correct, sir?

A. Yes, sir.

Q. When did that happen?

A. In 1940-1939, when we developed approximately four stores. The produce delivered by wholesalers to the individual store represented such a variety of quality that it was obvious to the operational people in Giant serving the

(7)

consumer, that a standard for produce had to be established, and since the purchasing of the produce is a jungle in which standards are not kept, and very few standards are even set by the U. S. Department of Agriculture, it was decided that the best interests of Giant would be served if a central point for delivering all the produce would be established, at which point produce could be screened, and only

* Figures in parentheses refer to page numbers of typewritten transcript.

that produce that represented the standards for the sale to consumers through Giant could be shipped to that particular store, and so at that time a produce company was established in the names of the two families, and this company was called the Washington Wholesale Produce Company.

This Produce Company did not have sufficient buying power to buy truckloads or carloads, so that it would coordinate with other wholesalers in the process of purchasing. Frequently it would buy a third of a truckload, or a half of a truckload, but the other wholesaler would always be the one who took the responsibility for the billing.

The reason for establishing the Washington Wholesale Produce Company was such that if Giant were to set up its own produce operation, the unions at that time had all of the corporate chains organized, whereas none of the wholesale produce companies were organized, and it was obvious to the Giant management that if they wanted to get the quality of

(8)

produce they needed, they had to have a central point at which the produce was delivered. Then the Washington Wholesale Produce Company sold to other retailers. Washington Wholesale Produce Company also had the benefit of having the non union relationship. The wholesale produce companies in the area had a Produce Association in which these wholesale produce companies all worked together in the process of trying to set standards, and of trying to work out hours and regulations that would be of help to the whole industry. So that the service to the Giant consumers on the part of the families was such that they would be better off establishing a wholesale produce business in 1939 or 1940, and they did so.

* * *

(9)

Q. When did the Produce Company adopt the name Max Shapiro?

A. The war, in 1942, imposed on the part of the shipper, the primary seller, the responsibility of setting up quotas, if he was going to be fair to his buyers, because there was not enough product, with the Army and all the rest of the armed services purchasing, and all the merchandising went on a quota system.

The Washington Wholesale Produce Company, which was in existence in 1942, did not have the foresight to get its name on the list. It bought through other wholesalers, and when the quota system was established, the other wholesalers said to the Washington Produce Company, "You don't have any quota with us", so the Washington Produce Company continued to operate as a wholesaler at a tremendous disadvantage, attempting to pick up product.

In 1944 an individual by the name of Max Shapiro, who was one of the largest wholesale produce people in the

(10)

Greater Washington area, elected to sell his business, and it became public knowledge that this business was for sale.

The people who operated the Washington Wholesale Produce Company, in the interest of serving Giant Foods, recognizing that they had tremendous quotas, because Max Shapiro, being the largest wholesaler, and having the largest quotas, decided to purchase Max Shapiro, but not in the name of Washington Wholesale Produce Company, because they would have then lost the quotas. So they purchased the Max Shapiro business and rented the facilities of the Max Shapiro Company, and started and continued to sell both to retailers and to Giant under the name of Max Shapiro.

* * * *

(15)

Q. What function does Max Shapiro perform for Giant Foods?

A. Max Shapiro has the responsibility of being the clearing agent for all produce, to make sure that the stand-

ards of quality that Giant Foods needs in its retail stores will measure up to the qualities established.

As the clearing agent it has the responsibility of assembling and shipping to Giant Foods this merchandise of this particular quality that we have established.

As you will recall, in 1939 when we had the Washington Wholesale Produce Company, we couldn't get the type of quality that we had established, so we had to set up a central clearing agency.

(16)

Q. Does the board of directors review annually or at any other set period the relationship between Giant and Max Shapiro with a view to continuing it or terminating or adjusting the relationship?

A. I would have to—in order to answer your question, I would have to go back to 1959, when a determination in relation to this was made for the board as such, in which it had to make certain conclusions, and that in itself affected what determinations followed from there on. Would you permit me to do that?

Q. Yes, go right ahead, sir.

A. Prior to the prospectus being developed, and the company being marketed, the underwriters, Auchincloss, Parker & Redpath, in urging that Shapiro was a positive value in itself, suggested that the Shapiro Company could be put into Giant, and that the underwriters would provide in their opinion 135,000 shares, that in their opinion would be the value of the Shapiro Company.

As a director at that time, with the Shapiro Company earning $300,000, and with the statement on the part of the directors that this company would pay in the area of 40 cents a share, the individuals in the Shapiro Company felt that in order to get $300,000, that the offer of the underwriter of 135,000 shares was not adequate for the acquisition of the

(17)

Max Shapiro Company, and they suggested a *quid* for the *quo,* and that 750,000 shares be considered the figure that properly represented the value of Max Shapiro. Seven hundred and fifty thousand times 40 cents would then give the individuals the same number of dollars that they were then drawing out of Max Shapiro.

The underwriters recognized that this was a reasonable request and countered in the area that perhaps 335,000 shares would be more right, because then they would get 40 cents a share on the 335,000, and this represented pretty much a dollar a share, which was the earnings of the company at that time, and therefore they would give them a share for each dollar's worth of earnings, or $300,000.

When it was thought through by the directors, that 335,000 shares would have to be issued, for Giant it would dilute the total of all of the shares, and when the underwriters thought through the total proposal offered, it was decided that it would be in the interest of both all of the people, plus the people who purchased the stock, to continue this unique produce relationship that had been established with much blood, sweat and tears in order to arrive at the kind of produce standards we have to have. As a consequence, the underwriters felt it would be best to continue the arrangement as it was, and I as a director from 1959 forward

(18)

have had to look to that particular relationship in making my decisions as to whether it should continue purchasing from the Shapiro Company.

Q. I take it, sir, that after that decision was made in 1959, the board no longer reviewed the relationship between Max Shapiro and Giant, with a view to terminating that relationship?

A. No, it is constantly under review, and the feeling has constantly been that the unique *esprit de corps* that

has been developed within the Shapiro Company for the purpose of serving Giant is a very unique relationship as a consequence, this particular thing should be protected, and since it was made part of the public's awareness during the prospectus and at all times made aware to everybody, that there was no situation here except serving all of the people who were interested in purchasing Giant Food.

Q. Prior to the institution of the lawsuit by Mr. Futrovsky, did any director of Giant suggest at any board meeting that the relationship with Max Shapiro be terminated or curtailed in any fashion, sir?

A. There were discussions on many occasions as to where could we find such an unique relationship, and from time to time this was thought through, but at no time was there ever a conclusion that this should be curtailed.

(19)

Q. Did any director ever make a proposal that perhaps the relationship should be curtailed, sir?

A. The discussions were that if it were advisable to, then we should evaluate it and curtail it, but in none of the final conclusions did the conclusion that we should curtail it.

Q. Do you remember the name of the director or directors who suggested that the relationship should be discontinued?

A. Myself. Yes, I did.

Q. Did the board study your proposal, sir?

A. Yes.

Q. As a result of that study what did the board determine, sir?

A. That the unique relationship of this assembling organization, and its standards of quality that had been developed over the period of 24 years of existence, was too precious to tamper with.

Q. Was this the unanimous decision of the board, sir?

A. Yes.

Q. You then, I take it, agreed with this decision?
A. Yes.

* * *

(23)

Q. Are there any other items of inventory purchased through a clearing agent, or through the same setup that you have for produce, sir?

A. I don't understand the question.

Q. Well, for example, does Giant sell meat products to the public, sir?

A. Oh, yes. I think I now understand. I said before that in areas where we have a jungle—"jungle" meaning that there aren't specific standards—in the general merchandise field, where there are so many varieties of socks or shirts or things of this type, we will work through a wholesaler, frequently referred to as a rack jobber.

In the purpose of groceries, where we buy Del Monte, or Libby, where there are identical standards on every particular can, we purchase from the primary source, but that is a reasonably simple operation because the standards are there.

For meat we have U. S. Government grades, and all of our meat is sold on a U. S. Government basis. There we have established standards, and so there we buy from the primary source and distribute ourselves.

Where the standards are not clear, the good will of

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the customer is such that we do not just lose the profit on the particular trade in produce. If we happen to lose on a particular sale of oranges, if the consumer coming into the store gets oranges that are not good, we don't lose just the profit on the oranges, we lose the customer, and the customer's business. Our desire in the area of the jungle to have the kind of specialized knowledge we need, is such that we go to tremendous lengths in these jungle areas to get the most skillful and competent type people.

* * *

(26)

Q. Prior to the institution of the lawsuit by Mr. Futrovsky did the board of directors or did you, sir, give any thought or consideration to hiring the employees now employed by Max Shapiro?

A. Yes. I had to make the over-all thought in relation to the total cloth pattern, using the "cloth" as an advisable word. The produce managers and store managers of Giant Foods have been instructed from 1939 forward that when they get produce from Max Shapiro, that produce is coming from a wholesale operation, and if that produce in any way is not satisfactory to them, they can send it back to Max Shapiro, and that it is their responsibility to see to it that they only keep that produce that is worthy of what Giant should sell.

If we were to take these same people who are in the Max Shapiro Company and just automatically convert them to Giant, which was the question you asked me, we would lose, in our opinion, the relationship so far as the produce manager and the store manager is concerned, and the 25 years of indoctrination that we gave to them, and they would then accept whatever came out of what would now be the Giant warehouse, to the Giant store, and the customer would get the merchandise, and if the customer was dissatisfied we would not

(27)

lose the profit on the oranges, we would lose the customer, as I said before, so as a consequence when we had to weigh the whole situation, we came to the conclusion that by transferring these people we would lose something precious, and therefore we decided that we should keep it the way it is.

* * *

(28)

Q. Does Max Shapiro have any competition, sir, in its sales of produce to Giant?

A. It has the competition of keeping Giant competitive at retail, as outlined in the prospectus, and therefore it has the competition of the purchasing agents of the Great A & P Company and of the Safeway Company, and all the competition that Giant has to compete against.

* * *

(34)

Q. What percentage of produce sold by Max Shapiro to Giant is returned in the average year, sir?

A. In the period over the last year or two I would say pretty much one to two per cent is returned. The relationship between the Shapiro people and the Giant people has become such, with the standards being set over 20 to 25 years, that the need for return has become less and less.

Q. When produce is returned to Max Shapiro, can it, in turn, return that produce to the place where they purchased it?

A. They cannot.

* * *

(35)

Q. I believe you said that within the last few years one or two per cent of the produce sold of Max Shapiro to Giant was returned?

A. Yes.

Q. Was that percentage higher in the past years?

A. Yes. In the periods from 1944 to, perhaps, 1950, the ratio was much higher.

* * *

(49)

Q. If Giant, sir, were to hire directly the entire staff of Max Shapiro, it would realize a savings, would it not, sir?

A. I do not think so. The question of skill, the question of responsibility, the question of relationship—the

minute it changed there would be something lost, and this something that is lost, in my opinion—and I have seen it happen time and time and time again, where you say you will just transfer the work to another group, and everything will remain the same—somewhere along the line when you transfer certain kinds of responsibility and say, "We are going to go through the same motions and everything will remain the same," it doesn't work that way.

Q. Is it your opinion, sir, if Mr. Kramer and his fellow workers were employed by Giant, they wouldn't do the same fine job that they are doing under Max Shapiro's employment?

A. They would have a different set of standards to work by. In the case of working for Giant and shipping to Giant they no longer would have the responsibility where their merchandise could be returned to them.

They wouldn't think as a wholesaler does. There is a process of thinking when you are a wholesaler, that is

(50)

different than when you are a retailer, and if these people were retailers, if they were in the employ of Giant, somewhere in the process there would be a different kind of thinking, there would be a different kind of position-taking so far as purchases are concerned, and somewhere in this whole process we would lose the moneys that are supposedly being earned by Shapiro—that is, a question as to whether they are earned.

Q. To infuse the employees of Max Shapiro with this spirit that you have just related, is it necessary for Max Shapiro to make profits, sir?

A. In my opinion the skills of the people in Shapiro are directly traceable to their knowledge that they have to operate and produce as a wholesaler, and as a wholesaler they apply a particular and peculiar kind of effort in serving Giant that can't be captured if they are taken away from this relationship.

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(56)

ISREAL COHEN, one of the defendants, called as a witness by the plaintiff, being first duly sworn by the Notary Public, testified as follows:

* * *

EXAMINATION.

By Mr. Silverman:

* * *

(60)

Q. Thank you. Now, sir, if Giant were to absorb the Max Shapiro operation, wouldn't it realize savings in the amount that you have mentioned?

A. Not in that amount, no.

Q. Why is that, sir?

A. Well, the relationship of Max Shapiro as a wholesaler wouldn't be the same as it would as a retailer. In the buying and purchasing of fresh fruits and vegetables sometimes decisions are taken that are quite risky, and as a wholesaler we can and as a retailer we wouldn't be able to take that position.

Q. Is it your testimony, sir, that in the purchase of produce Max Shapiro runs risks, sir?

A. From time to time, yes.

Q. What is the nature of those risks, sir?

A. Well, lemons, for example, can sell one day for $3 a crate, and the next day go up to twelve or thirteen. If you have a frost in Florida, your citrus fruits can go from $3 to $8 to $10.

* * *

(61)

Q. How is the price that Giant pays Max Shapiro for its produce determined, sir?

A. I would say that a substantial part of the time, on the basis of what their product costs. A substantial part of the time it is on the basis of what the market compels Max Shapiro to sell, based on a competitive situation.

* * *

(62)

Q. Do you, sir, ever negotiate with Mr. Kramer?

A. I don't think it is a question of negotiating. The function of Max Shapiro is to provide perishables for Giant Foods, and keep Giant Foods at all times competitive with the market.

Q. Has Mr. Kramer on behalf of Max Shapiro ever accepted a lower price for produce than he has asked Giant to pay?

(63)

A. Oh, sure. Let me understand your question correctly.

(The reporter read the last question as follows:

"Q. Has Mr. Kramer on behalf of Max Shapiro ever accepted a lower price for produce than he has asked Giant to pay?")

The Witness: Yes.

By Mr. Silverman:

Q. Is that a usual process, sir, or an unusual process?

A. I would say that it is—that Kramer sets the price not necessarily on what he pays for it, but what Giant has to pay for it in order to be able to resell it on a competitive basis. For all practical purposes Kramer functions in Max Shapiro, as Max Shapiro and Giant Foods.

Q. Have you, sir, ever suggested that certain produce should be lower in price than what Max Shapiro has offered to sell it to Giant?

A. I called up this morning before I left. Safeway was selling corn at six for 29, and we were five for 29, and I asked him if he changed the price, and he said yes. We were six for 29 on a retail basis, and naturally the wholesale price will be changed.

Q. Are prices set by Mr. Kramer for the whole Giant chain, or are the prices set individually for each store?

A. The whole chain.

(64)

Q. Would Giant be able to sell its produce at a lower price, sir, if it absorbed the Max Shapiro operation?

A. I don't think so.

EXTRACT FROM PROSPECTUS OF GIANT FOOD INC. OF NOVEMBER 12, 1959.

(Plaintiff's Deposition Exhibit A for Identification.)

INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS.

The Company purchases its fruits and vegetables from Max Shapiro, a partnership. The beneficial interests in the partnership are held by the individuals listed under "Principal Holders of Securities—Beneficial Ownership" herein and members of their immediate families, except that N. M. Cohen and Joseph B. Danzansky have no beneficial interest in the partnership. In the partnership's fiscal year ended January 31, 1959, Max Shapiro's net sales to the Company amounted to $7,657,805, or approximately 8% of GIANT's total purchases. This amount represented 100% of Max Shapiro's total sales and 100% of the Company's fresh produce purchases during the period. The prices quoted by Max Shapiro to GIANT are dictated by competitive circumstances, and the partnership's net earnings for the fiscal year ended January 31, 1959, before income taxes, partners' salaries and withdrawals, were $334,715 or about 4.4% of Max Shapiro's net sales to GIANT. In the past seven fiscal years the corresponding net earnings of Max Shapiro varied from a low of 3.5% to a high of 4.4% of net sales to GIANT. Max Shapiro rents its produce warehouse from the Company under a lease which requires rental payments of $72,000 per year and still has eight years to run. The data contained in this paragraph regarding Max Shapiro are derived from audited statements of the partnership prepared by Schultz, Sorin & Co., independent Certified Public Accountants. It is the intention of the partners of Max Shapiro that net profits of the partnership in future years continue in the percentage range established in the past seven years.

COMPLAINT.

Plaintiff, by his attorneys, Cohen & Morris, Esqs., as and for his complaint, alleges upon information and belief except paragraph "1", which is alleged upon knowledge:

1. Plaintiff is a shareholder of Giant Foods, Inc. (the "Company"), owning 50 shares of the Company's Class "A" non-voting stock. He has been a shareholder at all times since 1959.

2. Plaintiff brings this action derivatively on behalf of the Company and representatively on behalf of himself and all other shareholders similarly situated.

3. The Company is a Delaware corporation, and has been engaged in the management and operation of supermarkets located primarily in the Washington, D. C. area.

4. The individual defendants are all non-residents of the State of Delaware.

(a) Defendants N. M. Cohen, Jacob Lehrman, Israel Cohen, Joseph B. Danzansky, and Charlotte Ferson Lehrman are and have been the Company's directors.

(b) In addition to their positions as directors, N. M. Cohen is and has been the Company's president; Jacob Lehrman is and has been the Company's secretary and executive vice-president; and Israel Cohen is and has been the Company's vice-president. Emanuel Cohen is and has been the Company's treasurer.

(c) Israel Cohen, Emanuel Cohen, and Lillian C. Solomon (sometimes referred to collectively as the "Cohen Family") own, between them, the entire beneficial interest in Max Shapiro, a partnership that supplies and has supplied the Company with all its fresh produce requirements.

5. (a) The Company has 250,001 voting securities. The Cohen interests own 125,000 voting shares (Class AC) and are entitled to elect 2 directors; the Lehrman interests own 125,000 voting shares (Class AL) and are entitled to elect 2 directors; and Joseph B. Danzansky owns 1 voting share (Class AD), and is entitled to elect 1 director.

The individual defendants own the following voting shares of the Company:

Israel Cohen	—	41,500	Class AC
Emanuel Cohen	—	41,500	Class AC
Lillian Cohen Solomon	—	41,500	Class AC
N. M. Cohen	—	500	Class AC
Total:		125,000	Class AC *
Jacob Lehrman	—	125,000	Class AL
Joseph B. Danzansky	—	1	Class AD

* N. M. Cohen, as trustee, is the record owner of all the Class AC stock, and has the sole power to vote said shares.

(b) The shares in the hands of the public, which are traded on the American Stock Exchange (Class A), are non-voting.

6. The Cohens and Lehrmans, through their (1) ownership of virtually all of the Company's voting securities and (2) official positions with the Company control and dominate the Company's affairs. This control and domination is used to benefit themselves, and to harm the Company, as set forth below.

7. The Cohen Family, with the consent and approval of Jacob Lehrman and Charlotte Ferson Lehrman (sometimes referred to collectively as the "Lehrman Family"), devised a means of diverting to themselves monies and profits which should inure to the sole benefit of the Company and its shareholders.

8. The means used by the Cohen Family to effectuate this illegal purpose was the formation of a partnership doing business under the firm name and style of Max Shapiro.

9. (a) Max Shapiro's sole and entire business is to supply the Company with fresh produce.

(b) The Company purchases all of its fresh produce from Max Shapiro.

10. Max Shapiro enjoys a particularly favorable relationship with the Company:

(a) Max Shapiro rents the Company's warehouse on very advantageous terms;

(b) Max Shapiro uses, as its principal officers, defendants Israel Cohen and Emanuel Cohen, who are each paid $67,600 per year by the Company, none of which is reimbursed by Max Shapiro.

(c) The Company is committed to purchase daily from Max Shapiro everything that Max Shapiro purchases. Thus Max Shapiro is assured of a ready market for which it need incur no risk whatsoever.

(d) The daily purchases by the Company of Max Shapiro's entire inventory permits Max Shapiro to operate without any invested capital.

11. The Company does not need the services of Max Shapiro.

(a) Max Shapiro's main facility, its warehouse, is owned by the Company.

(b) Max Shapiro's principal officers are full time employees and officers of the Company.

12. Despite the facts that Max Shapiro (1) performs a function that could and should be performed by the Com-

pany, (2) incurs no risks in performing this function, and (3) has no capital invested, nevertheless it is able to realize substantial profits from its dealings with the Company.

(a) In the fiscal year 1963, Max Shapiro made a profit of $368,350; in fiscal year 1962, a profit of $446,428; and in fiscal year 1961 a profit of $400,885.

13. Although Max Shapiro has none of the ordinary business risks which the Company has, it nevertheless realizes a much higher rate of profit on its sales than does the Company:

	The Company	*Max Shapiro*
	1960	
Gross Sales	$131,927,000	$7,598,000
Profit Before Taxes	3,018,000	334,715
Profit as a Per Cent of Gross Sales	2.3%	4.4%
	1961	
Gross Sales	$146,723,000	$8,787,000
Profit Before Taxes	3,965,000	400,885
Profit as a Per Cent of Gross Sales	2.7%	4.5%
	1962	
Gross Sales	$162,062,000	$9,264,000
Profit Before Taxes	3,798,000	446,428
Profit as a Per Cent of Gross Sales	2.3%	4.8%
	1963	
Gross Profits	$179,124,000	$9,473,000
Profit Before Taxes	2,758,000	368,350
Profit as a Per Cent of Gross Sales	1.5%	3.9%

14. If the profits diverted to Max Shapiro had, instead, been retained by the Company, the Company's pre-tax earnings would have been increased by the following percentages:

Fiscal Year Ended January 28	*Percentage Increase in Company's Pre-Tax Earnings*
1960	11.1%
1961	10.1
1962	11.7
1963	13.3

15. It is the practice and custom for supermarket chains to purchase all of their inventory, including produce, directly from the supplier, thus eliminating any profits that might otherwise accrue to middlemen and wholesalers.

(a) The Company follows this practice and custom for all of its inventory items, except for produce. The only reason for this exception is to divert to Max Shapiro monies and profits that should belong to the Company and its shareholders.

16. The Cohen and Lehrman families together enjoy favorable positions as landlords of at least 3 of the Company's supermarkets. As landlords, they receive annual rents of at least $234,000. The Lehrman family thus also benefits from its relationship with the Company.

17. The above transactions constitute a waste and spoliation of the Company's assets, and constitute violations by each of the individual defendants of the fiduciary duties they owe to the Company and its shareholders.

(a) Each of the individual defendants is liable, jointly and severally, for participating in, authorizing, and allowing, through negligence and gross negligence, the aforementioned wrongs.

18. Demand upon the Company's board of directors is unnecessary for at least the following reasons:

(a) Each of the directors is liable for the wrongs set forth above;

(b) Each of the directors participated in and allowed, through negligence and gross negligence, the wrongs set forth above; and

(c) The institution of this action by the directors would place it in hostile hands and would prevent its effect prosecution.

19. Plaintiff has no adequate remedy at law.

WHEREFORE, plaintiff prays for judgment as follows:

A. An order pursuant to 10 Del. C. Section 366, requiring the non-resident defendants to appear by a day certain and authorizing sequestration of their property in Delaware and appointing a Sequestrator to hold the same;

B. An order requiring the individual and partnership defendants to account to the Company for its losses and their gains and profits;

C. An order awarding plaintiff his attorney and counsel fees, and for any other expenses incurred in this action; and

D. For such other and further relief as may be just and necessary.

IRVING MORRIS,
COHEN & MORRIS,
North American Building,
Wilmington, Delaware,
Attorneys for Plaintiff.

ANSWER OF INDIVIDUAL DEFENDANTS.

First Defense.

Defendants Emanuel Cohen, Jacob Lehrman and Israel Cohen, appearing in their individual capacities only and not as partners of Max Shapiro, and N. M. Cohen, appearing as an individual, answer the complaint as follows:

1. These defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 1 of the complaint and demand strict proof thereof, except that they admit that 50 shares of Giant's Class A stock have been registered in the name of Charles J. Futrovsky since December, 1959.

2. These defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 2 of the complaint.

3. These defendants admit the allegations of paragraph 3 of the complaint.

4. In answer to the allegations of paragraph 4 of the complaint, these defendants admit that the individual defendants are all non-residents of the State of Delaware and that defendants N. M. Cohen, Jacob Lehrman, Israel Cohen, Charlotte Ferson Lehrman and Joseph B. Danzansky are and have been since 1959 the directors of the company and that the following defendants hold and have held since 1959 the offices in the company set opposite their respective names:

N. M. Cohen	President and General Manager
Jacob Lehrman	Executive Vice President and Secretary
Israel Cohen	Vice President in Charge of Operations
Emanuel Cohen	Treasurer

Except as admitted by the foregoing, the allegations of paragraph 4 of the complaint are denied.

5. In answer to the allegations of paragraph 5 of the complaint, these defendants admit that the Company has 250,001 voting securities; that Israel Cohen, Emanuel Cohen, and Lillian Cohen Solomon each own beneficially 41,500 shares of the Company's Class AC stock; that N. M. Cohen owns beneficially 500 shares of the Company's Class AC stock; that N. M. Cohen, as Trustee, is the record owner of all the Class AC stock and has the sole power to vote said shares and that the record owners of Class AC stock are entitled to two Directors; that Jacob Lehrman owns beneficially and of record 125,000 shares of the Company's Class AL stock, and that the holders of Class AL stock are entitled to elect two Directors; that Joseph B. Danzansky owns beneficially and of record 1 share of the Company's Class AD stock, and that the holders of Class AD stock are entitled to elect one Director; and that the shares in the hands of the public which are traded on the American Stock Exchange (Class A) are non-voting. Except as admitted by the foregoing, the allegations of paragraph 5 of the complaint are denied.

6. These defendants deny the allegations of paragraph 6 of the complaint.

7. These defendants deny the allegations of paragraph 7 of the complaint.

8. These defendants deny the allegations of paragraph 8 of the complaint.

9. These defendants deny the allegations of paragraph 9 of the complaint.

10. These defendants deny the allegations of paragraph 10 of the complaint.

11. These defendants deny the allegations of paragraph 11 of the complaint.

12. These defendants deny the allegations of paragraph 12 of the complaint, except that they admit that in the fiscal year ending January 26, 1963 Max Shapiro made a profit before income taxes and partners' salaries of $368,350, in the fiscal year ending January 27, 1962 a similar profit of $446,428, and in the fiscal year ending January 28, 1961 a similar profit of $400,885.

13. These defendants admit that the consolidated gross sales, consolidated profit before taxes and consolidated profit as a percent of consolidated gross sales of the Company and subsidiaries for the fiscal years 1960 through 1963 are correctly stated in paragraph 13 of the complaint; and that the gross sales by Max Shapiro to the Company and its subsidiaries, Max Shapiro's profit before taxes, partners' salaries and withdrawals, and Max Shapiro's profit as a percent of its gross sales to the Company and its subsidiaries are correctly stated in paragraph 13 of the complaint, except that for fiscal year 1960 the gross sales by Max Shapiro to the Company and its subsidiaries were $8,276,055, its profit before taxes was $351,519 and its profit as a percent of its gross sales to the Company and its subsidiaries was 4.2%. Except as admitted by the foregoing, the allegations of paragraph 13 of the complaint are denied.

14. These defendants deny the allegations of paragraph 14 of the complaint.

15. These defendants deny the allegation of paragraph 15 of the complaint.

16. These defendants deny the allegations of paragraph 16 of the complaint.

17. These defendants deny the allegations of paragraph 17 of the complaint.

18. These defendants deny the allegations of paragraph 18 of the complaint.

19. In answer to paragraph 19 of the complaint, these defendants allege that plaintiff has no remedy whatsoever, at law or in equity, for the reason that defendants have committed no wrong.

SECOND DEFENSE.

20. The complaint fails to state a claim upon which relief can be granted.

THIRD DEFENSE.

21. Plaintiff has failed, without justification or legal excuse, to make demand upon the Board of Directors of the Company that their claim or claims, if any, set forth in the complaint be asserted by the Company.

22. The allegations of paragraph 18 of the complaint fail to constitute sufficient reason for non-compliance with Rule 23(b) of the Rules of this Court and do not state a claim upon which relief can be granted.

FOURTH DEFENSE.

23. In December, 1959, when plaintiff first became a registered owner of shares of the Company, the Company's then current prospectus, dated November 12, 1959, which on information and belief plaintiff received at the time of his purchase of his shares of the Company, stated, among other things, substantially as follows:

> "The Company purchases its fruits and vegetables from Max Shapiro, a partnership. The beneficial interests in the partnership are held by the individuals listed under 'Principal Holders of Securities—Beneficial Ownership' herein and members of their immediate families, except that N. M. Cohen and Joseph B. Danzansky have no beneficial interest in the partnership. In the partnership's fiscal year ended January 31, 1959, Max Shapiro's net sales to the Company

amounted to $7,657,805, or approximately 8% of GIANT's total purchases. This amount represented 100% of Max Shapiro's total sales and 100% of the Company's fresh produce purchases during the period. The prices quoted by Max Shapiro to GIANT are dictated by competitive circumstances, and the partnership's net earnings for the fiscal year ended January 31, 1959, before income taxes, partners' salaries and withdrawals, were $334,715 or about 4.4% of Max Shapiro's net sales to GIANT. In the past seven fiscal years the corresponding net earnings of Max Shapiro varied from a low of 3.5% to a high of 4.4% of net sales to GIANT. Max Shapiro rents its produce warehouse from the Company under a lease which requires rental payments of $72,000 per year and still has eight years to run. The data contained in this paragraph regarding Max Shapiro are derived from audited statements of the partnership prepared by Schultz, Sorin & Co., independent Certified Public Accountants. It is the intention of the partners of Max Shapiro that net profits of the partnership in future years continue in the percentage range established in the past seven years.

"The leases on seven of the Company's stores have been entered into with Giant Food Properties, Inc., a corporation in which N. M. Cohen, Mr. and Mrs. Jacob Lehrman, Emanuel Cohen, Israel Cohen, and Mr. and Mrs. Lawrence P. Solomon have an aggregate common stock ownership estimated at approximately 15%. The minimum aggregate annual rental on the above seven leases is $518,000. The Company has also agreed to lease space in one other shopping center which Giant Food Properties, Inc. is developing or planning to develop.

"These same individuals, with the exception of N. M. Cohen, own a 50% interest in a shopping center

at 1909 Willow Lawn Drive, Richmond, Va., where the Company operates a supermarket. A 35% interest in a shopping center at 3100 Queen's Chapel Road, Hyattsville, Md., where the Company operates a supermarket, is owned by the individuals listed in 'Principal Holders of Securities—Beneficial Ownership' herein with the exception of N. M. Cohen. Giant Food Profit Sharing Plan owns 100% of the stock of a corporation which in turn owns a shopping center at Columbia Pike and Little River Turnpike, Annadale, Va., where the Company operates a supermarket.

"In each case the terms of the foregoing leases (copies of which are exhibits to the Registration Statement) are deemed by the Company to be comparable with the terms of leases executed by the Company in cases where no affiliation exists.

"All other leases executed by the Company have been entered into with non-affiliated landlords.

"In addition, the Company expects, in 1960, to lease a store to be built on property located on Annapolis Road in Prince Georges County, Maryland, in which Jacob Lehrman, Israel Cohen, Emanuel Cohen and Mrs. Lawrence Solomon hold a 90% interest as tenants under a 99-year lease."

Reference is made to said prospectus for the full and exact contents thereof.

24. Similar full and fair disclosures were made by the Company in prospectuses dated February 24, 1961, October 4, 1961, February 13, 1963 and October 29, 1963. Said prospectuses are on file with the Securities and Exchange Commission and the American Stock Exchange and open to inspection by plaintiff and all other stockholders of the Company. Reference is made to said prospectuses for the full and exact contents thereof.

25. The stockholders of the Company, including the plaintiff, have waived any claim or claims stated in the complaint.

FIFTH DEFENSE.

26. Paragraphs 23 and 24 of this answer are incorporated herein by reference.

27. The alleged claim or claims, if any, set forth in the complaint are barred by the statute of limitations.

SIXTH DEFENSE.

28. Paragraphs 23 and 24 of this answer are incorporated herein by reference.

29. The alleged claim or claims, if any, set forth in the complaint are barred by laches.

SEVENTH DEFENSE.

30. Paragraphs 23 and 24 of this answer are incorporated herein by reference.

31. The stockholders of the Company, including the plaintiff, are estopped to assert the claim or claims, if any, alleged in the complaint.

EIGHTH DEFENSE.

32. The transactions referred to in the complaint were ratified and approved by all the stockholders of Giant and, therefore, plaintiff is barred from maintaining this action.

WHEREFORE, these defendants pray for the entry of judgment in their favor dismissing the complaint and assessing costs against plaintiff.

BERL POTTER & ANDERSON,

By RICHARD F. CORROON,
350 Delaware Trust Building,
Wilmington, Delaware,
Attorneys for Defendants.

NOTICE TO STOCKHOLDERS.

To the Stockholders of Giant Food Inc.:

This is to inform you of certain developments in the above lawsuit. A Stipulation of Settlement has been signed for the settlement of this case, which is conditioned upon a finding by the Court that the settlement is fair and reasonable and should be consummated. In accordance with the procedure in such situations, the Court has directed that a hearing be held before it passes upon the fairness and reasonableness of the settlement.

You are hereby notified that pursuant to an order of the Vice Chancellor of the State of Delaware, dated December 23, 1964, in accordance with Rule 23(c) of the Rules of the Court of Chancery of the State of Delaware, a hearing upon the fairness of the settlement will be held in the courtroom of the Court of Chancery of the State of Delaware, in and for New Castle County, Eleventh and King Streets, Wilmington, Delaware, at 10.30 o'clock A. M., Eastern Standard Time, on January 27, 1965. Any stockholder of Giant Food Inc. ("Giant") may show cause, if any he has, at the hearing why the settlement of this action, as provided in the Stipulation of Settlement, should not be approved by the Court as fair and reasonable and why this action should not be dismissed, as provided in the Stipulation of Settlement. The hearing may be adjourned from time to time by announcement at the hearing or at any adjournment thereof without further notice.

The plaintiff in this action is a stockholder of Giant, who acquired his shares in December, 1959. The action was instituted derivatively purportedly in behalf of and for the benefit of Giant. It was commenced on February 13, 1964.

The defendants, N. M. Cohen, Emanuel Cohen, Jacob Lehrman and Israel Cohen, have appeared in this action. No other defendants have been served or appeared in the

action. Each of the defendants who has entered an appearance has joined in the Stipulation of Settlement.

The complaint alleges that Giant has been engaged in the management and operation of supermarkets located primarily in the Washington, D. C. area; that the individual defendants have been directors of Giant, and that Israel Cohen, Emanuel Cohen and Lillian C. Solomon ("Cohen Family") own between them the entire beneficial interest in Max Shapiro, a partnership that supplies Giant with all its fresh produce requirements. It is alleged that of Giant's 250,001 shares of voting stock, the Cohen and Lehrman interests own 250,000; that Joseph B. Danzansky owns the remaining share; and that the Cohens and Lehrmans dominate and control the affairs of Giant.

The complaint charges that the Cohen Family, with the consent and approval of the Lehrmans, formed a partnership named Max Shapiro; that Max Shapiro's sole business is to supply Giant with fresh produce; that Giant purchases all of its produce from Max Shapiro; that Max Shapiro rents a warehouse from Giant on very advantageous terms; that Max Shapiro uses Israel Cohen and Emanuel Cohen as its principal officers, although each of them are paid $67,600 per year by Giant, none of which is reimbursed by Max Shapiro; that Giant is committed to purchase from Max Shapiro everything that Max Shapiro purchases, and thus has a ready market at no risk; and that daily purchases by Giant of Max Shapiro's entire inventory permit the latter to operate without any invested capital. It is also charged that Max Shapiro has realized substantial profits from its dealings with Giant, e.g., $368,350 in the fiscal year 1963, $446,428 in the fiscal year 1962, and $400,885 in the fiscal year 1961; that Max Shapiro realizes a much higher rate of profit on its sales than does Giant; and that if the profits allegedly diverted to Max Shapiro had been retained by Giant, Giant's earnings would have been increased. It is alleged that it is the practice and custom of supermarket chains to purchase all

of their inventory, including produce, directly from the supplier, thus eliminating profits that might otherwise accrue to middlemen and wholesalers; that Giant follows this practice for all of its inventory items, except produce; and that the only reason for this exception is to divert to Max Shapiro monies and profits that should belong to Giant and its stockholders.

It is also alleged in the complaint that the Cohen and Lehrman families together enjoy favorable positions as landlords of at least three of Giant's supermarkets and that as landlords they receive annual rents of at least $234,000.

The complaint charges that the above transactions constitute a waste of Giant's assets, for which the defendants should account to Giant.

The defendants have disclaimed any wrongdoing or liability whatsoever. The appearing defendants have answered the complaint and deny each and every material allegation contained therein and assert that the charges made by the plaintiffs against them are entirely without merit.

The defendants contend that when Max Shapiro was first purchased in 1944, at a time when all the outstanding stock of Giant was owned by members of the Cohen and Lehrman families, it was for the benefit of Giant since Max Shapiro had OPA quotas for produce which were unavailable to Giant, and that thereafter Max Shapiro's quotas were made available to Giant, thus permitting it to sell greater quantities of produce. When Giant first sold its shares to the public in the fall of 1959, its then current prospectus, dated November 12, 1959, fully disclosed the relationships between Max Shapiro and Giant and also fully disclosed the leases to Giant of stores in which members of the Cohen and Lehrman families had interests, including a lease which Giant expected to enter into in 1960 of a store in which members of those two families had interests on Annapolis Road in Prince George's

County, Maryland. The prospectus also stated that in the seven fiscal years preceding January 31, 1959 the net earnings of Max Shapiro varied from 3.5% to 4.4% of net sales to Giant and that it was the intention of the partners of Max Shapiro that net profits of the partnership in future years would continue in such percentage range. Defendants contend that in 1959, when Giant first sold its shares to the public, the members of the Max Shapiro partnership had a choice of either keeping their partnership interests or transferring them to Giant and that if they had done the latter, the capitalized value of the partnership interests would have been approximately $3,000,000, for which they would have received appropriate compensation. The defendants also contend that the continued existence of Max Shapiro and its dealings with Giant is for the best interest of Giant in that it insures Giant's ability to obtain produce of a superior quality than could be obtained from other wholesalers.

The plaintiff, through his attorneys, has made a thorough investigation into the facts and circumstances involved in this action. His attorneys have taken the oral depositions of Emanuel Cohen, Israel Cohen and Jacob Lehrman, as individuals and as Vice President, Treasurer and Executive Vice President, respectively, of Giant. In addition, plaintiff, through his attorney, has inspected a large amount of documentary material.

In order to avoid further expenses, inconvenience and the distraction of burdensome and uncertain litigation, and to put to rest all controversy, the parties have agreed to a compromise of the litigation which has been incorporated in a Stipulation of Settlement, subject to the approval of the Court. The principal terms of the Stipulation of Settlement are as follows:

1. A contract will be entered into between Max Shapiro and Giant, whereby Max Shapiro will agree that its net earnings after management salaries (which are limited to an aggregate of $50,000 per year during the term of the

contract) but before income taxes and withdrawals will not exceed 3.9% of Max Shapiro's net sales to Giant or $350,000, whichever is lower; provided, however, that for the fiscal year ended January 31, 1966 Max Shapiro's net earnings shall be limited to 3.9% of its net sales to Giant or $325,000, whichever is lower. For the fiscal year ended January 25, 1964, Max Shapiro's net earnings were $403,767. For the fiscal year ending January 31, 1965 it is estimated that net sales by Max Shapiro will amount to $10,700,000. 3.9% of such figure is $417,300. For the fiscal year ending January 31, 1966 it is estimated that net sales by Max Shapiro to Giant will amount to $12,100,000. 3.9% of such figure is $571,900. The contract between Max Shapiro and Giant will be for a term of ten years, at the end of which Giant will have an option to buy the business of Max Shapiro, including Max Shapiro's equipment, office furniture, tractors and trailers, trade-names, trade-marks and good will, but excluding Max Shapiro's cash, securities, accounts receivable, liabilities and other partnership assets not heretofore specifically enumerated for $1,500,000, payable in cash.

2. Giant will pay plaintiff's attorneys the disbursements incurred in the prosecution and settlement of this action, plus the sum of $100,000 as payment in full of all expenses, including attorneys, counsel and accountants fees incurred by plaintiff, his attorneys, counsel and accountants, if any, in this action.

3. Giant shall execute and deliver to Max Shapiro, to each of the individual defendants, and to all past or present directors of Giant a release discharging each of them from any and all claims arising out of the matters alleged in the complaint.

4. An order shall be entered by the Court approving the Stipulation of Settlement and dismissing the complaint with prejudice as to each of the defendants who is a party

to the Stipulation of Settlement and the past or present directors of Giant who have been named as defendants in the action and who shall have entered an appearance therein before the entry of such order of the Court.

At the hearing on January 27, 1965, any stockholder of Giant or party to this action may present any evidence that may be relevant to the issues to be heard; provided, however, that no such person who is not a party to the Stipulation of Settlement shall be heard and no papers or briefs submitted by any such person shall be received or considered by the Court, except by special permission of the Court, unless on or before January 22, 1965 a notice of intention to appear, a statement of the position to be asserted and of the grounds therefor, and copies of such papers and briefs are served on Irving Morris, Esquire, 1101 Bank of Delaware Building, Wilmington, Delaware, attorney for the plaintiff; Pomerantz Levy Haudek & Block, 295 Madison Avenue, New York, New York, of counsel to the plaintiff; Howard M. Handelman, Esquire, 1006 Bank of Delaware Building, Wilmington, Delaware, attorney for Giant; and Richard F. Corroon, Esquire, 350 Delaware Trust Building, Wilmington, Delaware, attorney for the defendants, N. M. Cohen, Emanuel Cohen, Jacob Lehrman and Israel Cohen, and filed with the Register in Chancery, Public Building, Eleventh and King Streets, Wilmington, Delaware. The Stipulation of Settlement, the depositions and exhibits referred to therein, all documents produced by defendants for examination by plaintiff's attorneys, and all pleadings and other documents in the action will be on file on and after January 4, 1965 with the Register in Chancery, Public Building, Eleventh and King Streets, Wilmington, Delaware, and available for inspection either by any stockholder of the corporation, in person or by duly authorized attorney, during regular hours on each day other than Saturdays, Sundays and other legal holidays.

By Order of the Court of Chancery of the State of Delaware, in and for New Castle County.

GIANT FOOD INC.

By .....
Secretary.

Dated: Wilmington, Delaware,

....., 1965.

FINAL ORDER OF THE COURT OF CHANCERY.

This 3rd day of February, 1965, this action having come on for hearing on January 27, 1965 pursuant to the Order of this Court entered herein on December 23, 1964 for the purpose of considering the adequacy and fairness of the Stipulation of Settlement herein, which, among other things, provides for the payment of the sum of $100,000 to Messrs. Cohen, Morris & Rosenthal, attorneys for the plaintiff, plus the disbursements incurred in the prosecution and settlement of this action, and it appearing that notice of the hearing on January 27, 1965 was given to all stockholders of Giant Food Inc. of record at the close of business on December 23, 1964 in accordance with the terms of the Order of December 23, 1964, and Jesse A. Cash, and Leonard S. Goodman and Barbara L. Goodman having filed their objections to the proposed settlement of this action and having been heard, and the Court having duly considered the evidence and arguments offered in support of the settlement and compromise and the objections thereto, and it appearing that the settlement is fair, adequate and reasonable and in the best interests of Giant Food Inc. and all its stockholders, it is

ORDERED, ADJUDGED AND DECREED:

1. The settlement and compromise of this action, as provided in the Stipulation of Settlement, dated December 23, 1964, which has been filed in this action, and said Stipulation are approved and found to be fair, adequate and reasonable and in the best interests of Giant Food Inc. and all its stockholders.

2. The complaint in the above action is dismissed with prejudice and judgment is entered in favor of the defendants, N. M. Cohen, Emanuel Cohen, Jacob Lehrman and Israel Cohen.

3. Plaintiffs and defendants are directed to make effective the settlement and compromise of this action in accordance with the terms and conditions of the Stipulation of Settlement, dated December 23, 1964, and upon execution of the contract referred to in paragraph 1 of said Stipulation, Giant Food Inc. is directed to execute and deliver a release in the form attached to said Stipulation to each of the persons named in said release.

4. The Court hereby reserves jurisdiction of this cause with respect to all matters relating to the consummation of the settlement and, in particular, with respect to the award of counsel fees and expenses to the attorneys and counsel for plaintiff.

/s/ ISAAC D. SHORT, 2ND,
Vice Chancellor.

Office-Supreme Court, U.S.
FILED
FEB 28 1966
JOHN F. DAVIS, CLERK

No. 932

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

LEONARD S. GOODMAN and BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY, Plaintiff-Appellee Below, and N. M. COHEN, EMANUEL COHEN, JACOB LEHRMAN, ISRAEL COHEN, GIANT FOOD, INC., CHARLOTTE FERSON LEHRMAN, JOSEPH B. DANZANSKY; and ISRAEL COHEN, EMANUEL COHEN, and LILLIAN C. SOLOMON, doing business as MAX SHAPIRO, Defendants-Appellees Below, *Respondents.*

REPLY TO THE BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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REPLY TO THE BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

Appellees argue that the Chancery Court only exercised an equitable discretion to approve their settlement and the Delaware Supreme Court but decided whether the Chancery Court had abused its discretion. With this they seek to establish a non-federal ground for the decision below and to avoid the merits.

Futrovsky, purporting to represent all stockholders of Giant, agreed to a settlement in the Chancery Court

on the assumption that all stockholders had consented to the arrangement between Giant and Shapiro, and that he could only hope to hold the officers and directors of Giant to a "reasonable" profit from the arrangement. As the Delaware court noted, "In the light of this conclusion the settlement agreement was negotiated" (Petition, p. 5a). All the present appellees premised this conclusion exclusively on the ground that the Securities Act of 1933 required the delivery of a prospectus to all prospective buyers of stock in 1959, and hence each of the original stockholders bought with knowledge of the Giant-Shapiro arrangement. (Petition, pp. 1a-2a). The Chancery Court held that the entire cause of action set forth in Futrovsky's complaint "could not, in all probability, withstand the defense of estoppel." (*id.* at 3a). Since the Chancery Court took no evidence showing an estoppel, its ruling necessarily involved the acceptance of appellees' interpretation of the Securities Act. It, therefore, rested its decision on federal grounds.

Whether or not the Chancery Court expressly ruled on the effect of the Securities Act, the matter was presented for its decision and was necessary to its approval of the settlement before it, thereby raising a federal question.[1] An interpretation of the Securities Act was necessary to its decision for the reason it is well-settled in Delaware that, if approval or disapproval of a proposed settlement turns on the construction of a statute, the Chancery Court will make the necessary construction in addition to determining the overall "fairness" of the settlement, as the cases relied

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[1] *Bell's Gap R. Co.* v. *Pennsylvania,* 134 U.S. 232, 236; *Erie R. Co.* v. *Purdy,* 185 U.S. 148, 154.

upon by appellees show.[2] The Chancery Court is required "to consider and weigh the claims and possible defenses" before approving a settlement. *Saminsky* v. *Abbott,* 194 A. 2d 549, 551 (Del. Ch. Ct. 1963), aff'd *sub nom. Kleinman* v. *Saminsky,* 200 A. 2d 572 (Del. S. Ct. 1964), *cert. denied,* 379 U.S. 900, where the Chancery Court construed the Investment Company Act of 1940 (at 551) before reaching the reasonableness and fairness of the settlement (at 551-53). And see *Manacher* v. *Reynolds,* 165 A. 2d 741 (Del. Ch. Ct. 1960), where the Chancery Court also first construed the Investment Company Act (at 746-47) before reaching any issue of the "fairness" of the settlement (at 748).[3]

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[2] On the other hand there are important distinctions between some of the cases cited by appellees and the present case. Appellees' cases for the most part involve a stockholder's attack upon the business judgment of an independent board of directors, unlike the present case where the officers and directors are interested appellees. The Delaware courts will normally defer to the judgment of disinterested directors without further inquiry. *Perrine* v. *Pennroad Corp.,* 47 A. 2d 479, 487-88 (Del. S. Ct. 1946); *Krinsky* v. *Helfand,* 156 A. 2d 90, 94 (Del. S. Ct. 1959); *Hoffman* v. *Dann,* 205 A. 2d 343, 350 (Del. S. Ct. 1964), *cert. denied,* 380 U.S. 973. The case of *General Foods Corp.* v. *Cryo-Maid, Inc.,* 198 A. 2d 681 (Del. S. Ct. 1964), heavily relied on by appellees, involved only an "appeal from an interlocutory order granting a stay and settling no substantive legal rights." (at 682).

[3] *Dann* v. *Chrysler Corp.,* 198 A. 2d 185, 196 (Del. Ch. Ct. 1963), aff'd *sub nom. Hoffman* v. *Dann, supra,* involved the legal effect of corporate bylaws in addition to the fairness of a settlement. Later in awarding fees the Chancery Court stated in a dictum quoted by appellees (Opposition Brief, p. 8), that it had not determined the claims as in ordinary litigation. In the very next sentence, however, which was not quoted by appellees, the Court added that, "Nevertheless, where, as here, the merits of the claims are not admitted, the plaintiffs have the burden of showing that they filed meritorious claims." (215 A. 2d 709, 713).

What was implicit in the decision of the Chancery Court was made explicit by the Delaware Supreme Court. The latter expressly ruled that the Securities Act "required as a practical matter that the 1959 purchasers of Giant stock be furnished with a copy of the Prospectus," and having made their purchases "with full knowledge" of the Giant-Shapiro arrangement, the stockholders "could not, therefore, successfully complain" of the arrangement. The present petitioners, the court added, "are bound by the acquiescence, with full knowledge, of their predecessors and are now precluded from attacking the Giant-Shapiro relationship." The settlement was thereupon considered only "upon the alternate theory of recovery." (Petition, p. 10a).

It may be that the Delaware Supreme Court could have decided this case upon broad equitable grounds, and not have construed the Securities Act. It chose not to; and having chosen to decide a federal question, the Delaware Court may not now be said to have rested on a non-federal ground. *Steele* v. *L. & N. R. Co.*, 323 U.S. 192, 197 note 1; *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 98.

Moreover, it is clear that the Delaware Supreme Court would not have countenanced legal error by the Chancery Court under any view of its appellate jurisdiction. The review of an exercise of discretion in Delaware involves the determination of whether the lower court, "in view of the relevant rules of law and upon due consideration of the facts of the case could reasonably have reached the conclusion of which complaint is made." *In re Public Service Holding Corporation*, 24 A. 2d 584, 587 (Del. S. Ct. 1942). "Where, however, the [lower] court in reaching its conclusion

overrides or misapplies the law . . . an appellate court will not hesitate to reverse." *Pitts* v. *White,* 109 A. 2d 786, 788 (Del. S. Ct. 1954).

The decision of the Delaware Supreme Court raises a federal question, even if we view it as expressly deciding no issue of federal law. In its consideration of the claims and defenses, it erroneously considered the effect of the Securities Act as precluding all relief, except that which had been negotiated. On petition for certiorari the jurisdictional question is whether "the same judgment would be rendered by the state court after we corrected its views of federal laws." *Herb* v. *Pitcairn,* 324 U.S. 117, 126. The Delaware Supreme Court tells us that the buying public would have a cause of action, and could seek an end to the Giant-Shapiro relationship, if it had been "misled to its injury" by the initial sale of stock in 1959. (Petition, p. 9a). The sole ground for deciding that the buying public had not been misled to its injury was the court's reading of the Securities Act. The federal ground of the decision controlled the judgment. Contrast *Enterprise Irrig. Dist.* v. *Canal Co.,* 243 U.S. 157, 164, where Constitutional and independent equitable grounds of estoppel do appear.

We urgently renew our petition that this Court give plenary consideration to the important question of federal law decided below. Appellees have not contested in their Opposition Brief the showing of the Petition that the Securities Act authorizes delivery of a prospectus after stock purchases have occurred, and that delivery will often, if not normally, take place in this fashion. The decision below is manifestly wrong.

Prior to the decision of the Delaware court it seemed "safe to assume that, absent any conflict with federal law, whatever common law or statutory remedies may otherwise exist are not affected by any of the SEC statutes." 1 Loss, *Securities Regulation*, 156 (2d ed. 1961). The Delaware court improperly construes the 1933 Act not only to cut off preexisting common law remedies, but with an effect contrary to the interests of public investors and only to shield corporate officers and directors.

We may particularize and further show the devastating effects of the decision below on the interests of innocent investors. It was not contested below that petitioners bought their shares on the American Stock Exchange without notice of this litigation or of any of the matters and things involved in the litigation.[4] Petitioners were bona fide purchasers for value of their Giant stock. But they are now held to the notice allegedly given to their predecessors in interest, not upon any proof that such notice was given, but solely upon an erroneous interpretation that the Securities Act required their predecessors to receive a prospectus containing the requisite notice before they bought their shares.

Congress never intended that the Securities Act be used to cut off the common law rights of investors buying new public shares, and much less the rights of subsequent bona fide purchasers. Moreover, if bona fide purchasers are to be estopped from complaining of matters disclosed in a prospectus allegedly given to

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[4] See petitioners' "Notice of Intention to Appear, Position to be Asserted and Grounds for Position To Be Asserted," filed in the Chancery Court, and also reproduced in the Appendix to the Brief of Appellants in the Delaware Supreme Court, p. A-72.

their predecessors, the lower court should not be permitted by a construction of federal law to encourage the smallest distribution of the prospectus prior to effective stock sales.

The construction of the Securities Act below is not designed to protect innocent investors, but rather to destroy their rights as public investors and bona fide purchasers. The ruling is at such wide variance from the holding of this Court in *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38, as to require reversal by this Court.

Respectfully submitted,

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SUPREME COURT, U. S.

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FILED
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PETITION FOR REHEARING

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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PETITION FOR REHEARING

On March 21, 1966, the Court entered an order denying the petition for a writ of certiorari filed in this case. The Chief Justice and Mr. Justice Black were of the opinion that certiorari should be granted. This petition respectfully requests the Court to rehear the petition for a writ of certiorari and upon such rehearing to grant certiorari.

The Delaware Supreme Court has held that petitioners and all other public shareholders of Giant Food,

Inc., a corporation operating some 70 supermarkets in the Washington—Baltimore area, may not complain that the officers and directors of the corporation are requiring it to purchase its produce requirements through a partnership composed of and profiting such officers and directors. The lower court rests its decision on the grounds that all stockholders (or their predecessors) waived objection to the arrangement, since they allegedly purchased their stock with actual notice of the arrangement. The lower court premises this alleged waiver solely on an erroneous construction that the Securities Act of 1933 required delivery of a prospectus containing notice of the arrangement to all prospective buyers of Giant's newly-issued public shares in 1959 before purchases were consummated.

We have urged that this Court should reverse this patently erroneous interpretation of the Securities Act, for in shielding the corporate officers and directors from suit, it causes the Act to work against the interests of new public investors and subsequent bona fide purchasers in a manner never intended by Congress. The holding will operate to encourage the smallest distribution of the prospectus, for it eliminates the need for proof that the prospectus was delivered which heretofore ensured a wide distribution of the prospectus. We have urged that no State court may lawfully make use of such an erroneous and harmful interpretation of Federal law for the purpose of effectuating local law. See *Standard Oil Co.* v. *Johnson*, 316 U.S. 481.

We believe we cannot overstress that the ruling below favors management and the securities industry against the interests of public investors flatly contrary to

the intent of Congress in enacting the Securities Act. As early as 1941, the Securities and Exchange Commission favored an amendment to the Securities Act under which a prospectus must be delivered before a dealer could offer to sell newly issued shares of stock.[1] The securities industry opposed the amendment and it was not adopted. The Delaware court, however, has construed the delivery requirement as if the amendment had been adopted, but not for the protection of investors as the Commission intended, but only to impose a waiver of stockholder rights while at the same time keeping intact the looser delivery requirements of the Act.

Moreover, the court below assumes, contrary to logic, that a mere legal requirement of delivery automatically means there has been delivery; the securities industry would have been satisfied in 1941 if Congress had enacted only a rebuttable presumption that the buyer had received a prospectus if the dealer or issuer could show "proof of the mailing of a general prospectus or of such a confirmation" of the stock sale.[2]

The ruling below is so arbitrary it could not withstand this Court's review even if it contained no express reliance upon the Securities Act. Thus, if this Court should hold, as it properly may, that the Securities Act does not require delivery of a prospectus to all prospective buyers, nor to anyone prior to effective sales, the lower court could not on remand lawfully

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[1] "Proposed Amendments to the Securities Act of 1933 and to the Securities Exchange Act of 1934," Hearings before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pp. 196, 328 (1941).

[2] *Id.* at 186.

say that solely for purposes of State law it will hold that a prospectus is delivered to all prospective buyers of new shares prior to their effectuating any purchases. In the absence of any law or evidence compelling that conclusion, any such ruling would be completely arbitrary and deprive petitioners of due process of law. Petitioners would be denied a fair hearing if subjected to such arbitrary or capricious power, *American Ry. Express* v. *Kentucky,* 273 U.S. 269, 273, whether the State acted through its legislative, executive, or judicial branches, *Brinkerhoff-Faris Co.* v. *Hill,* 281 U.S. 673, 680. Petitioners would be entitled to the judgment of this Court, if the lower court in this manner sought to deny due process to rights asserted under local law. Cf. *Demorest* v. *City Bank Co.,* 321 U.S. 36, 42.[3]

We submit that the Delaware court will not be able to avoid this Court's lawful interpretation of the Securities Act by couching its holding strictly in terms of local law. It was crucial to the decision below, in the absence of evidence, that it believed the Securities Act required all purchasers of new shares to receive a prospectus, in order to hold that the original purchasers of the public shares bought with actual knowledge of the arrangement between Giant and its management. If the lower court's view of the Securities Act is corrected by this Court, and since respondents failed to adduce any evidence in point, the lower court will

[3] A decision below depriving petitioners of their cause of action by imposing an arbitrary waiver would deprive petitioners of their property without due process of law as much as the State court's attempted deprivation of all existing remedies through the discovery of an allegedly exclusive remedy in *Brinkerhoff-Faris, supra,* or the arbitrary transferance of title through resuscitation of a dead cause of action spoken of by this Court in *Stewart* v. *Keyes,* 295 U.S. 403, 417.

be required to hold that there has been no waiver of stockholder rights to complain.

Petitioners respectfully renew their request that the Supreme Court give plenary consideration to the arbitrary construction of the Securities Act by the Delaware Court.

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